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ABSTRACT

These technical papers were presented at the Conference on Treatment of Assets and Income from Assets in Income Conditioned Programs. Six papers dealing with current and alternative treatments of assets and income from assets in programs that offer both cash and noncash benefits were presented. The first three authors reviewed the network of rules that govern eligibility and size of benefit in the leading income conditioned programs. The other three authors considered more hypothetical questions. One looked at negative income tax plans for welfare reform; a second looked at schemes for annuitizing welath held in the form of an owner-occupied home; and the third looked for insight to the literature on taxation of consumption. All the papers showed concern for the goals of existing programs and for the need to achieve these goals in an equitable and efficient manner. The central question before the conference was: Should assets and income from assets count, and if so, how, in determining elibigility and benefit levels in income-conditioned programs? The three papers on existing programs showed that practice varies rather widely from one program to another and, in some programs, from one state or locality to another. However, several major programs, namely SSI, food stamps, AFDC, and Medicaid, seemed to be converging toward what was referred to as the SSI Standard. Several possibile changes in the SSI Standard were reviewed at the conference, and these are discussed briefly here. Each of the seven possible changes raised complex and controversial questions. Most conferees found the matter of asset testing difficult, if not distastful, to discuss. Perhaps this explains why little careful study on this topic has been done to date. However, although no unanimity was achieved on any one question, there were a few points on which a consensus was reached. These are mentioned. (Author/AM)

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The Treatment of Assets and Income from Assets in Income-Conditioned Government Benefit Programs

TECHNICAL PAPERS

Prepared for

THE FEDERAL COUNCIL ON THE AGING

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by

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FOREWORD

The 1973 Amendments to the Older Americans Act created the fifteen member Federal Council on the Aging to serve as a spokesman for the elderly in advising the President, the Congress, the Secretary of the Department of Health, Education, and Welfare and the Commissioner on Aging on matters relating to the special needs of older Americans.

These amendments also mandated the Council to undertake a study of the interrelationships of Federal, State and local government benefit programs for the elderly. The Council was required to develop recommendations for bringing about greater uniformity of eligibility standards, and for eliminating the negative impact that one program's standards may have on another. (See FCA study, The Interrelationships of Benefit Programs for the Elderly with three appendices).

One of the inequities reported in the study concerned how Federal benefit programs treat assets. It was noted that several programs which help older Americans, including Supplemental Security Income, Medicaid, Food Stamps, Pensions for Veterans with Non-service-connected Disabilities, and some housing programs, use asset tests as well as income tests in determining eligibility for participation. The rationale for employing an asset test is that persons with substantial wealth should not be helped even if their measured income is low since assets can either be sold or used for support or be converted into income-producing assets.

Asset tests as presently used cause four types of inequities. First, a small increase in a persons's assets can result in loss of eligibility for a program yielding sizeable benefits. Second, because there is usually an exemption for owner-occupied housing, asset tests discriminate against persons who rent housing. Third, asset tests discriminate against the aging vis a vis the non-aging since elderly persons of a given economic status are more likely to have accumulated wealth than the young and middle-aged and are more dependent upon wealth income. The impact of asset testing may fall more heavily on one group among the elderly, for example the elderly residing in rural areas compared to those residing in urban areas. Definitions of countable assets vary among the programs, leading to inconsistencies and complexities.

Therefore, in order to begin to understand the national policy dilemmas concerning assets, the following recommendation was made:

> The Federal Council on the Aging will initiate a study of the philosophical and administrative rationale connected with the way in which assets and asset income are considered in determining eligibility for benefit programs and the various options available to reduce the inequities in the existing asset tests.

In 1976, the Council began a study of asset tests by having a paper prepared by economist Betty Duskin on the philosophic and economic basis

for asset tests and recommendations for a process to develop more equitable and efficient alternatives to current practice. The paper reviewed philosophies of income maintenance, the economic basis of asset tests, the existing approach and an alternative strategy, equity of asset tests and administrative complexity and costs. The conclusions in the paper were:

1. On economic grounds, assets should be included to determine economic position or need.

2. The present method of asset testing represents a philosophic extreme by requiring partial asset exhaustion as a condition of eligibility.

3. Asset tests have certain undersirable incentive features:

   a. they act as a disincentive for saving
   b. they are inherently biased toward the non-saver
   c. they invite avoidance efforts

4. Categorical asset exclusions or limitations undermine the intent of asset tests by inducing changes in savings behavior; they are also inequitable since they discriminate not on the basis of wealth holding but on the basis on the form in which wealth is held.

5. Many assets present valuation problems. Presumed conversion into liquid form for current consumption needs may be a realistic possibility, particularly in the case of the owner-occupied home.

6. Exclusion of all or part of an owner-occupied home is inadvisable since it is the major asset of most households and because its exclusion would bias program eligibility against renters.

7. There is a dearth of literature delineating the conceptual issues and existing literature on asset tests suggest that well-reasoned thought may lead to different conclusions.

The paper recommended that both the conceptual issues in asset testing and the state of current knowledge regarding the distribution of income and wealth be addressed. For comprehensiveness of approach, it was recommended that a number of study papers be commissioned to increase the knowledge base on asset tests and to provide a choice of options for consideration.

The Council, after study of the paper, agreed to proceed with further work on a study of assets. The following work plan was developed:

1. Commission research papers by experts in such areas as law, economics and social work on six asset testing topics.

2. Critique of the papers by other experts and a review of the papers in terms of national policy implications at a national conference.

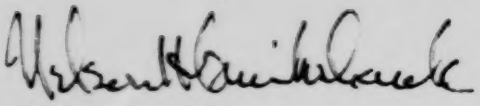
3. The development of a report that includes the papers and an overview of the conference

4. An FCA report on the issues and alternatives and recommendations for national policy on the treatment of assets and income from assets in income conditioned programs for the elderly.

The Federal Council on the Aging acknowledges the excellent work of the staff of the Institute for Research on Poverty of the University of Wisconsin in arranging the conference and editing this publication. The authors are commended for the high quality of the papers they prepared.

The views presented in the technical papers are the views of the authors and do not represent an official position of the Federal Council on the Aging. These papers are a first step in attempts to improve equity and programs aimed at meeting the special social needs of the elderly.

The issues in this report are being studied by the Federal Council. Recommendations for national policy on the treatment of assets and income from assets in income-conditioned programs for the elderly are being developed by the Council and will appear in a separate publication.



Nelson H. Cruikshank
Chairman

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An Overview: Issues and Choices

Robert J. Lampman

1. HISTORICAL BACKGROUND

Means testing was an integral part of public transfers to the poor in Elizabethan England and, later, in colonial America. Poor relief was designed not only to confine payments to the most needy, but also to punish those who were seen as having caused their own poverty and thereby deter slothful or irresponsible behavior in others. At the extreme, this meant recipients of relief must take the ceremonial pauper's oath and surrender their civil rights.

In this tradition, relief was conditioned upon a statement that one was totally without assets, was lacking in capacity to earn an income, and had no relatives who could give adequate assistance. Authorities could deny benefits or condition them on labor performed in a workhouse when they judged the applicant--even a child--able to work. Relief payments, combined with other income, were meant to meet only minimum needs. Hence, benefits were reduced one dollar for each dollar of income from any other source.

With the passage of time, means testing has been selectively abandoned and modified. The first step away from the most harsh practices involved categorization of applicants for public assistance and recognition of variations in degree of individual fault for poverty. Hence, less onerous conditions were accorded those who experienced loss of income due to military casualty, blindness, widowhood, or old age. For these preferred categories,

work tests were no longer imposed and asset tests were relaxed to the extent that some assets could be held, subject to a governmental lien which was collected at the time of sale or transfer of the assets.

In recent times, the trend within public assistance has continued to be one of liberalization of means testing. Thus, the lien law fell into disuse in most states for most categorical programs. Similarly, relative responsibility has been sharply narrowed; that is, grandparents are no longer expected to contribute to a daughter's dependent child, nor are adult children expected to support their aged parents. In 1972, Supplemental Security Income (SSI) abolished the lien law and the responsibility of the adult child with respect to aged beneficiaries. (It is still deemed, however, that relatives are contributing to any aged person residing with them.) Since 1967 in the Aid to Families with Dependent Children (AFDC) program, and since 1972 in SSI, earned income does not result in a dollar for dollar loss of benefits. There are, on the other hand, some exceptions to this liberalizing trend. For example, Congress in 1971 directed states to impose a work test on AFDC mothers whose youngest child was six years of age or over, and in the 1960s some veterans' benefits were asset tested (albeit in a very limited manner) for the first time.

A second step away from the long tradition of means testing was taken with the introduction of social insurance. Workmen's Compensation (now referred to as Worker's Compensation) set up an assured fund to replace some fraction of earnings lost due to industrial accidents. Unemployment Compensation and Old Age, Survivors, and Disability Insurance are based on the same theory of social fault as Worker's Compensation, and provide partial wage-replacement out of earmarked contributions for those who confront specified contingencies. Unemployment Compensation has a work

test, and Old Age Insurance has a retirement test; but none of the social insurances has an asset test, nor do they reduce benefits because of the receipt of nonearned income. Since the theory of the above listed social insurances is to replace lost earnings, ownership of property and income flowing from property are judged to be irrelevant to eligibility and size of benefits. The other side of the coin is that benefits are scaled to prior wages rather than the needs of the beneficiary and therefore may be less adequate than public assistance for some families. Health insurance, as exemplified by Medicare, passed in 1965, is not keyed to wage replacement, but rather to the incidence of health care cost. Benefits do not vary with respect to either prior earnings or current income or assets of beneficiaries.

In view of the powerful trends to liberalize public assistance and to adopt and extend social insurance, one might have expected to see a continued move away from means testing. However, a substantial revival of means testing has occurred in the last decade with the rapid growth of in-kind, or noncash benefit programs wherein eligibility and size of benefit are related to income or assets. These programs offer subsidies or vouchers to consumers of health care, food, housing, higher education, child daycare, legal services, and other specified items. Means testing is used in these programs, just as in cash benefit programs, to contain the cost of the benefits or to target the benefits to those most in need.

It is notable that exclusions, deductions, and credits in the individual income tax are helpful to moderate- and higher-income persons in paying for some of these goods and services. For example, employer contributions to a private health insurance plan are excluded in calculating an employee's

taxable income and some health care expenses are tax deductible. This income tax help, unlike that of Medicaid, is extended without reference to assets owned.

Means tested in-kind programs currently pay out over $30 billion annually. Cash benefits in similarly means-tested programs amount to about $20 billion a year. It is likely that the $50 billion total could be $10 billion greater or smaller if assets and income from assets were treated more or less generously than they now are.

Means testing is likely to be extended to reach an even larger part of the population. Welfare reform plans now under active consideration would offer a new income-conditioned, asset-tested cash benefit to a sizeable number of "noncategorical persons," that is, those who are nonaged and nondisabled, and not in broken family situations. President Nixon's Family Assistance Plan, which was proposed in 1969 and which finally failed adoption in 1972, made an effort along this line. It would have imposed asset limits for eligibility, and would have reduced benefits dollar for dollar with receipt of nonearned income. President Carter's welfare plan of August 1977 would also vary benefits by asset level. Therefore, means testing is not simply a matter of historical interest; it is currently widely practiced, and it may be the wave of the future.

2. THE CONFERENCE

It was against this background of experience that the Conference on Treatment of Assets and Income from Assets in Income-Conditioned Programs was convened at the Institute for Research on Poverty in Madison, Wisconsin on May 13-14. Six papers were presented at that conference on current and

alternative treatments of assets and income from assets in programs that offer both cash and noncash benefits. Writers of the first three papers (Moon, Lurie, and Hausman) were asked to review the network of rules that govern eligibility and size of benefit in the leading income-conditioned programs. The second trio of authors considered more hypothetical questions. One looked at negative income tax plans for welfare reform (Lerman); a second looked at schemes for annuitizing wealth held in the form of an owner-occupied home (Chen); and the third looked for insight to the literature on taxation of consumption (Taussig). All the papers show concern for the goals of existing programs and for the need to achieve these goals in an equitable and efficient manner.

The three background papers on existing programs illuminate the variety of means tests now in use. As we mentioned earlier, the trend has been toward liberalization of such tests. Perhaps the midpoint of liberality current in the range of programs examined at the conference is represented by SSI. To be eligible for benefits under this program, an aged couple must have "countable assets" no greater in value than $2,250. However, the following are excluded or "noncountable": a home of any value; the first $1,200 of value in an automobile; the first $1,500 worth of personal effects; the first $1,500 worth of insurance; and the first $6,000 worth of nonliquid, income-producing property. This means that a couple could hold as much as $12,450 worth of assets plus a home of any value and receive maximum SSI benefits. However, if their assets were all "countable," another couple could be disqualified for receipt of any benefit if they hold as little as $2,251.

In addition to asset limits, SSI imposes a dollar for dollar, or 100%, benefit-reduction rate on "nonearned" income in excess of $20 per month.

This term as defined includes not only genuine income, but also return of past contributions, as in the case of annuities, pension funds, and Social Security (none of which, incidentally, are "countable assets"), and receipt of gifts. However, it does not include either net imputed rent from an owner-occupied home or capital gains. SSI does not invoke "relative responsibility" beyond the nuclear family, although it does reduce an aged person's benefit by an arbitrary one-third if he lives with an adult child. Earnings beyond $65 per month are subject to a 50% benefit reduction rate. This means, of course, that a person with a modest amount of current earnings is more generously treated by SSI than is a person with an equivalent amount of "nonearned" income. This treatment of income from assets and the use of asset limits in determining eligibility gives incentive to a potential beneficiary to invest in a home rather than other assets and to consume or give away assets in excess of the limits.

Some programs fall to the left and some to the right of SSI on an index of liberality of means testing. The Food Stamp program is somewhat less liberal with regard to asset limits, but has only a 30% benefit reduction rate on nonearned income. A number of the housing programs have relatively generous asset limits, particularly for elderly persons. One of these programs, namely, Section 8, has no asset limit, but instead includes 10% of the value of assets in "countable income" when calculating benefits. This same rule of counting some portion of assets as "income," based on the idea that some assets should be consumed or utilized for continuing eligibility, is found in the Basic Education Opportunity Grants for higher education program (BEOG). Perhaps the most liberal means test is found in the veterans' programs. The asset test in pensions for survivors of veterans is a discretionary one that ignores all property except when "it

is reasonable that some part of it be consumed for the survivor's maintenance." In this program, relative responsibility is not imposed, even on parents with respect to children.

Using SSI as our reference point, we can say that AFDC is less liberal in its means-testing provisions. In this case, the federal government sets a limit on countable assets of $8000 for a family of four. However, states may opt for a lower limit, and may set their own rules with respect to what is "countable," and whether liens on property will be required. General assistance operates beyond the reach of the federal government and often with local government discretion. This program is, in some jurisdictions, along with some state hospital or institutional care programs, the most harshly means-tested of all programs. Medicaid, which is the most expensive of the means-tested programs, allows states to set their own asset rules and they tend to key them to their AFDC and SSI standards. One special problem arises in the Medicaid program; benefits are not tapered to fall smoothly with rising income, but are "all or nothing." This difficulty is somewhat modified by permitting a "spend down" of income and assets on health care to attain eligibility.

Asset limits and benefit reduction rates on income from assets are embedded in a network of rules that define not only income and assets, but also the income unit and the income accounting period. The means test is more liberal, other things being equal, if the income unit is narrowly defined and if the accounting period is very short. Such provisions make it relatively easy for a person to avoid the full impact of otherwise stringent means tests, and thereby make a program more costly.

3. SEVEN CHOICES ON ASSET-TESTING

The central question before the conference was: should assets and income from assets count, and if so, how, in determining eligibility and benefit levels in income-conditioned programs? The three papers on existing programs showed that practice varies rather widely from one program to another and, in some programs, from one state or locality to another. However, several major programs, namely SSI, food stamps, AFDC, and Medicaid, seem to be converging toward what will be referred to as the SSI Standard. This treatment involves asset limits that vary by type of asset; a 100% benefit reduction rate on annuity proceeds and on income from assets, with the notable exception of income in the form of net imputed rent, where the benefit reduction rate is zero%; a narrow definition of relative responsibility; and no use of liens on property.

Several possible changes[1] in the SSI Standard were reviewed at the conference.

The first change, which takes its rationale from the existing individual income tax, would simply eliminate all asset limits and use current income as the appropriate measure of means. The argument here is that, since there is no net worth tax on positive income taxpayers, it is not fair to subject assistance beneficiaries to a rule that virtually requires them to reduce their assets. However, without an asset test someone could hold substantial assets in a form that yields no income and dissave large amounts and draw benefits at the same time. It is interesting to note that the major so-called negative income tax plans for welfare reform all now include either asset limits or asset utilization rules.

A second modification of the SSI Standard, which was discussed at the Conference, would also eliminate all asset tests, but would substitute

current consumption at any age, including that financed by the sale of assets, as the measure of means. This proposal draws its inspiration from the observation that current consumption is often a better indicator of a person's relative well-being than is current income and that, throughout a lifetime, people plan to accumulate and then to decumulate assets as a way to level out their consumption. In the strict so-called "life-cycle income model," people plan to die with zero assets. To interpose the requirement that assets must be disposed of in order to quality for assistance benefits is to interfere with a person's rational plans and to run the risk of denying aid to someone with a relatively low lifetime consumption level, while granting it to some one with a relatively high lifetime level.

The third change, which is based on practice in BEOG and in the Section 8 housing program, would replace asset limits by a rule that counts a fixed portion, say 10%, of all assets combined beyond some exemption as "countable income."[2] This exemption limit might be set at, say, seven times the poverty income level. Thus, if a person had $5,000 of nonexempt assets, his benefit would be reduced by $500 per year.

This benefit reduction rate of more than 100% on some property income, would tend to force the drawing down of nonexempt assets. Another way to phrase it: The person in the example would be expected to make a contribution to his consumption by dissaving $500 worth of his assets. The contribution would be smaller than $500 in the next year. This would minimize the political problem of paying benefits to those with large amounts of wealth. It would also avoid the inequity that presently arises of denying any benefits to those who have modest assets but very low income while granting benefits to others who have substantially higher income and only a few dollars less in assets, or a different mix of assets.

A fourth possible change is to continue the reporting of gifts and proceeds of annuities, but to drop the reporting of actual income from assets, and adopt instead the reporting of a fraction of total net worth that approximates actual income, including noncash income. The benefit-reduction to be applied to this income could be below the 100% rate now applied to nonearned income. This could, of course, be combined with the plan to force consumption of assets above an exemption. (See change number three outlined above.)

A fifth modification would broaden the SSI Standard definition of income to include net imputed rent from owner-occupied homes and unrealized capital gains. (Note that SSI excludes the principal value of the home from "countable assets.") The principal justification for not including these as income is the administrative difficulty involved in estimating noncash items of income. This change is an alternative to change number four. It would be consistent with the plan to encourage people to convert assets into annuities as set forth in change six below.

A sixth possible change in the SSI Standard would encourage people to convert assets into annuities, which, by their nature, involve consumption of assets. This could be done by reducing the benefit reduction rate (now 100%) on the proceeds of annuities, and by government promotion of a scheme to convert home equity into an annuity while leaving the annuitant free to live in the house. This would, it is argued by some, correct the present imbalance in the treatment of income in the form of net imputed rent on the one hand, and that of proceeds from annuities on the other.

A seventh change in the SSI Standard would reinstate the use of liens. This would allow a person to receive benefits in the form of a loan to be

repaid when an asset is sold or transferred. Considerable concern was expressed at the conference that indirect beneficiaries of public assistance grants may include nonpoor heirs of the direct beneficiaries. Changes numbers three and six address this concern, but failing the adoption of one of these plans, the only way to get at the alleged problem, which might be especially severe if change one or change two were adopted, is via the lien. Even that alternative, however, will not reach gifts of property made prior to application for benefits. Only some version of a relative responsibility rule will accomplish that.

Each of the seven possible changes raises complex and controversial questions. Most conferees found the matter of asset testing difficult, if not distasteful, to discuss. As one discussant put it, he felt uncomfortable to be locked into the internal contradictions of a sixteenth century law. Perhaps this explains why little careful study on this topic has been done to date. There was no unanimity on any question at the conference--no votes were taken. It is fair to say, however, that there was something approaching a consensus on the following points.

1. The proposal to shift the measure of means for taxes and transfers away from income to consumption intrigued all, but persuaded few.

2. Similarly, the proposal to ignore assets completely and use only current income as a measure of means had few backers. The general view was that wealth also matters.

3. However, there was no support for an abrupt cut-off of aid when assets reach some arbitrarily set limit, particularly when the exemptions vary by type of asset.

4. Neither was there support for the total exemption of any value of a home. This, plus exemption from countable income of net imputed rent

as presently practiced combine to give an unreasonable advantage to home owners as compared to those who invest in other assets.

5. As mentioned above, most of the experts agreed that "wealth also matters." The most popular change proposed at the conference seemed to be that which would group all assets together, set an exemption level, and select some fraction of nonexempt assets that would force some utilization of assets, and add that fraction to countable income. (See change number three.)

6. Few objected to having a higher benefit reduction rate on "nonearned" income than labor income. However, some argued for "taxing" genuine income from assets and the proceeds of annuities at less than the present 100%.

7. There was also widespread agreement that the rules on assets and income should be redesigned to encourage potential beneficiaries of these programs to look more favorably on the purchase of annuities. However, there appeared to be little support for adding to countable income the annuity benefit that would flow from assets.

8. There was little support for broadening the rules with regard to relative responsibility. However, there was a surprisingly strong minority in favor of reexamining the lien law concept.

9. The following issues can be mentioned as worthy of more study.

(a) How can Medicaid benefits be designed to relieve the abrupt all or nothing cut-off that now exists and that none of the proposed changes discussed at the conference would do much to ameliorate?

(b) How would the changes discussed affect farmers and other self-employed persons, some of whom, as one discussant put it, "live poor and die rich"?

(c) Would it make sense in the near future to push for a uniform treatment of assets and income from assets for several programs, for example, SSI and food stamps, and to handle the administration of the uniform treatment centrally?[3]

10. Concentration on the important equity and efficiency issues involved in means testing of benefits should not stand in the way of continuing review of possibilities of alternative ways--including social insurance and unconstrained provision as in elementary and secondary education--of extending social welfare benefits to American citizens.

NOTES

[1]None of these changes speaks to the special equity problem of Medicaid referred to earlier, namely, that its benefits are not, as are those of other programs, nicely tapered to fall with rising income.

[2]A variant of this scheme, called "annuitizing assets," would vary the portion of assets to be counted as income directly with the age of the applicant.

[3]See the mention of this idea in the Hausman paper.

The Treatment of Assets in Cash Benefit Programs for the Aged and Disabled

Marilyn Moon

The asset test is an often included but seldom studied component of means tests for eligibility to various cash transfer programs. Consequently little is known about the success of the asset test in disqualifying non-needy families--the traditional goal of means tests--or about other equity and efficiency effects. This paper examines the asset test in cash benefit programs for the aged and disabled. For this group, $6.5 billion in cash transfers in Supplemental Security Income and veterans' pensions were subjected to asset tests in 1974. Although these transfers are obviously important, they comprise only 12 percent of total cash transfers to the aged and disabled. Social Security and Workers' Compensation are neither asset nor strictly income tested.

As the most important asset-tested poverty program for the aged and disabled, this paper concentrates on Supplementary Security Income (SSI). The importance of the other programs regarding assets chiefly arises through interrelationships with SSI, complicating the equity and efficiency issues. Both specific problems regarding administration and enforcement and the broader issues of equity and incentive effects are discussed (parts 1-3). This paper then evaluates alternative approaches to asset-testing and their effects on a number of policy goals (part 4). The Michigan Panel Study on Income Dynamics for 1974 provides the basis for eligibility estimates for the alternative asset tests.[1]

1. SPECIFIC PROVISIONS AND ENFORCEMENT PROBLEMS OF SSI

The provisions for asset-testing within Supplemental Security Income and the interrelationships with the other programs raise a broad spectrum of issues. This section explores five specific concerns. The exact role of SSI in the total transfer framework underscores its supplemental nature and suggests that a study of SSI should not be undertaken in isolation. The exclusions allowed, the spend-down provision and the deeming of income and assets raise questions of the equity and incentive structure from asset-testing. Finally, this section briefly explores the problems of enforcement and state supplementation. Each of the specific problems with the resource tests raises broader issues of equity and incentive effects explored in parts 2 and 3.

In 1974, SSI replaced three categorical programs: Old Age Assistance, Aid to the Blind, and Aid to the Permanently and Totally Disabled. The federal government now provides standardized SSI payments that may be supplemented by the states. Supplemental Security Income fills in the gaps created by the other (mostly non-asset-tested) programs. Coverage gaps result for a number of reasons. Workers' Compensation provides immediate protection against disability but, in 1970, it was available to only 83 percent of all wage and salary workers (National Commission on Workmen's Compensation Laws 1973). Moreover, it provides benefits only when disability is work-related. In some states there is an upper bound on how many years workers can claim benefits. Although Social Security is more comprehensive by number of workers and type of disability covered, a certain number of quarters of employment are required to establish eligibility. Moreover, benefits under Social Security can be quite low for workers with limited previous earnings. The minimum Social Security benefit level for a retired worker was $101.30 per

month in 1975, although the actual minimum payment will be even lower for a survivor or worker with early retirement. SSI provided individual benefits of up to $157.70 per month in that year. Hence, even some Social Security recipients may receive SSI benefits. SSI is always supplementary to these other existing forms of government transfers.

Veterans' pensions, the only other asset-tested program, also provide limited coverage. Veterans and their families are eligible for pensions for old age and nonservice-connected disabilities if they meet the needs test. Since only 47% of the population are categorically eligible, coverage under this program could never be universal. Participation in veterans' pensions would generally preclude benefits from SSI or vice versa with no implied order of participation. The asset test for veterans' pensions varies on a case by case level, without even basic guidelines. Hence, specific treatment of veterans' pensions has not been directly attempted; rather, it is assumed that most of the general problems discussed here are likely to affect the veterans' pension program. If the asset test is capriciously applied, it undoubtedly generates serious equity problems.

SSI provides benefits for aged and disabled individuals or couples (if both are over 65 or disabled). It does not provide funds for additional dependents although they may be eligible for other transfer programs such as AFDC. Disabled children may also be eligible for payments, but other family members are not provided benefits. SSI requires relative responsibility only when eligibles are residing with relatives. For example, when an aged individual resides with his or her children, any SSI payment will be reduced by one-third. The federal SSI program contains no lien provisions on the home or other property.

The following formula describes a simplified SSI benefit calculation for families with pretransfer income below the guarantee level:[2]

$$B = G - vL^{*} - O - rN - W$$

$$Y = B + L + O + rN + W \qquad \text{when } N < M$$

and simplifying:

$$Y = G - vL^{*} + L$$

where B = benefit amount under SSI

G = guarantee level

L^{*} = labor income after allowed expenses

v = tax rate on labor income

O = other income (private pensions, etc.)

r = rate of return on assets

N = net assets

W = government transfer payments (aside from SSI)

Y = post-transfer income

L = labor income

M = asset limit

For families whose assets exceed the limit, income would be measured as:

$$Y = L + O + rN + W \qquad \text{when } N \geq M$$

Income from assets is subjected to a 100% tax rate (above a small disregarded on any income).[3] Although this is not strictly an asset test, it may also create equity and efficiency problems, particularly since earned income is taxed at only a 50% rate. Income from annuities, pension plans, trusts and gifts are also subject to the 100% tax rate. Since imputed income

from assets is not included, the form of asset held may also be influenced by this very high tax rate.

The actual asset test for SSI consists of several parts.[4] Separate treatment is given to household goods and personal effects (a $1500 limit on market value), automobiles ($1200 limit) and the face value of life insurance ($1500 limit). When any of these limits is exceeded, the excess is considered part of "countable" resources. Countable resources also include all liquid and some nonliquid assets, altogether not to exceed $2250 for a couple and $1500 for an individual. The nonliquid (those assets that cannot be readily converted to cash in 20 days) exclusions provide important potential ways to avoid the countable asset test. Since 1976, an owned home of any value is excluded. This also applies to the full value of an owner-occupied farm. Other nonliquid assets may be excluded under two main conditions: 1) if they are in a form in which the principal is outside the control of the potential SSI recipient, or 2) if they are used for self-support and provide a reasonable rate of return. In the first case, where assets have been channeled into a certain form such as a trust, pension fund, or annuity and the principal is no longer under the control of the beneficiary, the principal is not considered a resource. Income from this source paid to the beneficiary is, however, treated as unearned income and taxed at 100%. In the second case, investments that provide a reasonable rate of return (usually 6% or more) are not included in countable assets. This applies mainly to property income or interest in a business. Currently, a $6000 limit on gross value is placed on this latter exclusion (Speir 1977). Again, interest, rent and dividends are taxed at 100%. Thus, for either of these two exclusions of nonliquid assets, income will not increase. The principal will, however, remain intact and not directly alter the benefits.

The forms of assets excluded from consideration are likely to be important for those with large assets and insignificant for those whose total assets are small. The transactions costs for such financial arrangements probably preclude small asset holders from taking advantage of these exclusions. Indeed, empirical evidence from the Michigan survey bears this out. Those with highest asset income hold little of their net worth in liquid form, while those with low assets are more likely to hold cash (aside from an owned home).[5]

Families above the asset test may also become eligible by "spending-down" their resources until they are under the limit. No penalties are assessed for rapid decumulation; rather, the opposite is true. The family may immediately become eligible for benefits after spending-down. Moreover, if the assets are nonliquid, special arrangements can be made for the family to receive benefits while in the process of selling the asset. In spending-down, the aged or disabled beneficiary may directly consume the resource, give the resource as a gift, or even prepay debts as long as the payment is irrevocable. Consequently, an individual may be able to assure a continuing stream from those assets--for example, by prepaying rent. And in this particular case, prepaid rent does not subsequently count as income. Spending-down of assets at a rate greater than the SSI benefit foregone is also a way to temporarily raise current income. For example, if a couple has countable assets of $4000 and would otherwise be eligible for a yearly SSI benefit of $350, they can spend $350 per year in lieu of receiving SSI for 5 years. Alternatively, they could dissave more than $350 per year for a shorter period and raise their yearly cash flow (income plus dissaving) over what income plus the SSI benefit would provide.[6]

As currently established, the asset limits should not, in theory, disqualify many aged and disabled families. Few families have substantial assets. The asset test is avoidable for those with the means and the desire. Consequently, the asset test may actually eliminate only those with moderate net worth for whom the conversion of assets to less liquid forms is costly and complicated relative to the size of assets held, and those who desire not to spend-down rapidly.

Any discussion of the asset test needs to include the issue of the "deeming" of resources. Some of the resources of ineligible persons are assumed to be available to a potential SSI recipient who resides with others. This deeming can occur whether or not the aged or disabled person actually benefits from these resources. The two most important cases are of married couples with only one person categorically eligible, and disabled children who reside with their parents. For the married couple all resources are included in determining eligibility with the resource limit set at $2250 (the limit for a couple even though there is to be only one recipient). This approach recognizes the difficulty in separating a couple's net worth and, by using the higher asset limit, mitigates any resulting inequities. As mentioned earlier, income from relatives residing with eligible persons is also implicitly deemed to the eligibles to reduce benefit payments by one-third.

The deeming technique is, however, more troublesome in the case of disabled children. All resources of the parents over and above the asset limit ($1500 or $2250) are deemed to the child. It makes no difference whether there are additional children in the household; all of the additional assets are assumed to be available to the disabled child. The child is then

subject to the resource limit for a single individual. For example, a disabled child would be ineligible for SSI if the parents' assets exceed $3750 ($2250 for parents, $1500 for the child). The equity problems with this approach thus arise because all other persons in the household are ignored when determining eligibility.

The bias towards testing liquid resources more heavily is also reflected in enforcement. The household goods and automobile limits tend to be ignored unless "unusual" assets are reported. Certainly, they are not as readily measured as savings accounts and other more liquid assets. The length and complexity of the resource provisions complicate the enforcement problems. Finally, states that supplement SSI may establish different asset requirements and the degree of enforcement may also vary. Although states cannot tighten the standards for the federal payments, they may be able to effectively relax the standard by providing supplemental payments to those ineligible under the federal limitations. In practice few states exercise this latter option for assets; in 1975, no more than three states had more liberal asset provisions than the federal limits. Most states that provide supplemental benefits use the federal guidelines, and at least nine states set more restrictive limits for their supplemental payments (Rigby and Morrison 1976).

2. EQUITY ISSUES AND ASSET TESTING

One of the important overall issues of asset-testing is its effect on the equity of transfer programs. Any analysis of equity first requires two sets of definitions. Before an indicator of equality can be established, a measure of economic well-being must be formulated to make interpersonal

comparisons. Second, a number of specific equity definitions must be established to evaluate these interpersonal comparisons. Only then can we pursue the equity issues associated with asset testing.

If current income alone were used as the measure of economic well-being, then the asset problem could be easily resolved, because with such a measure comes the implicit assumption that assets do not matter. Asset income would be included in the measure, but any other form of asset testing would be unnecessary and actually lead to horizontal inequities. Low income would be sufficient to establish eligibility. However, a more comprehensive measure of well-being would include all resources that enhance a family's ability to command goods and services. Assets in some form would consequently be incorporated in this broader measure.[7] For the aged, the life-cycle or permanent income hypotheses of savings behavior indicate that this depletion of assets to enhance consumption is rational behavior.[8] It is generally assumed that the aged would desire to maintain stable consumption levels over time and hence would deplete their assets to guarantee this stability. For the disabled, a similar treatment would seem to be appropriate assuming that assets accumulated during the beneficiary's years in the labor force should also be dissaved to maintain consumption, unless further drops in future income were expected.[9]

Measures of well-being based on a life-cycle model support the most common proposal for converting a stock of assets into a flow commensurable with income. For those aged who expect a stable flow of future income (for example from Social Security, pensions or other welfare), a constant annuity could approximate the rational amount of depletion in each year.[10] This measure of well-being could be expressed as follows:

$$E = L + O + W + B + A$$

where E = current year's measure of economic well-being

L = labor income

O = other income (pensions, gifts, etc.)

W = government transfer payments (aside from SSI)

B = SSI benefits

A = annuity.

This measure of well-being corresponds to posttransfer income (defined in part 1) when the amount of dissaving plus the return on assets just equals the annuity--that is, $A = rN + D$.

A less commonly proposed solution for converting assets into a flow would treat the actual amount of dissaving in any period plus asset income as the contribution of assets.[11] This, then, directly corresponds to the posttransfer income measure. The dissaving approach captures only those assets actually used, while the annuity approach stresses that the decision not to dissave may simply indicate that a family places a higher utility on maintaining the stock of assets. Hence, to include only dissaving would understate the contribution of assets in any one year.[12]

Both of these approaches include only a fraction of total net worth in measured well-being for any one year. Such measures of economic status are consequently inconsistent with an absolute asset measure for determining eligibility. Since these measures convert the asset contribution into a flow comparable to income, both the asset flow and income should be treated consistently for determining eligibility.

Four separate definitions of equity will be used with the expanded measure of economic status to analyze the asset test: horizontal equity, vertical equity, horizontal target efficiency, and vertical target efficiency. Usually when a program treats equals equally (horizontal equity), vertical

equity also results. Most transfer programs provide higher benefits to those with lower resources. Thus, if the appropriate tradeoffs between resources occur so that equals are treated equally, those at higher levels of economic status can be identified and provided lower benefits (vertical equity). However, equal benefit payments to all individuals eligible for SSI would insure horizontal but not vertical equity. Thus, it is sometimes necessary to distinguish these two equity issues.

The terms horizontal and vertical target efficiency, as defined by Weisbrod (1970), refer to a different set of issues. Even if a transfer program maintains horizontal and vertical equity, total funding for the program may be so low that only a small portion of the amount needed may be directed at some target group. The target group would be defined as all those below a certain resource level (consistent with a comprehensive measure of economic status). The exact level is open to debate. Using the SSA poverty lines is one solution, but the target group could be more narrowly defined since many transfer programs do not provide sufficient benefits to move families across the poverty thresholds. For this analysis, I assume that the target group is the lowest 23% of aged and 45% of disabled families ranked by economic status. This corresponds to the approximate percentage of family heads eligible under the existing SSI program.[13] Horizontal target efficiency indicates the degree to which the target group is aided by the program.[14] Vertical target efficiency measures the degree to which benefits are confined to the target group. The emphasis here is not on the equity or sufficiency of the payments to the needy group, but rather on whether many non-target-group families receive benefits. A program can be very vertically target efficient, but fail in terms of the other equity measures.[15]

The effects of the liquid asset test of $1500 for an aged or disabled individual and $2250 for a couple can now be subjected to the various equity criteria. Currently, anyone below the limit is eligible for SSI, while anyone above is totally ineligible. Thus, no tradeoffs between income and a flow of assets are possible. A couple with high assets and low income is excluded, while another couple with no assets and higher income can receive benefits. For example, a couple with $2000 in nonproperty income and $2500 worth of assets that it wishes to dissave evenly over 10 years could add only $340 per year to its income flow through dissaving and interest.[16] Yet a couple with an income greater than $2340 could still be receiving SSI if it has assets less than $2250. In fact, the second couple could remain eligible, in 1976, with an income of over $3000. Moreover, if the family receives some of its income from labor or if it is eligible for state payments, the income limit is effectively used. This creates a violation of both horizontal and vertical equity.[17]

Because the countable asset limit is lower than the upper income eligibility limit, this test will exclude needy families, resulting in low horizontal target efficiency. The problem is more acute for the aged than the disabled since older families are more likely to have accumulated assets. In Table 2.1, some simple empirical results from a simulation of eligibility using the 1974 Michigan Panel Study on Income Dynamics suggest the magnitude of the problem. Because of the limited amount of asset information available from this data source, these results must be viewed as very tentative.[18] The first column indicates the impact of the countable (liquid) asset test on reducing eligibility for those who fall within the income limits. The second column displays hypothetical results assuming that the

excluded nonliquid assets are included in the $1500 and $2250 limits.[19] The housing test (excluding those with houses worth more than $25,000) and its effect when combined with the liquid asset limit are shown in columns 3 and 4. This column then reflects the potential for the asset test if nonliquid, investment assets were subject to scrutiny. Of all those disabled who fall within the income limits for eligibility, only 2.7% are ineligible by the countable asset test. For the aged the figure is 12.1%. Either including the housing test or the excluded investment assets would eliminate an additional 3% of aged families.

There may also be horizontal target efficiency problems in the opposite direction that yield overpayments to some families. Benefits to those with positive assets below the limit are reduced only to the extent that the assets generate income. Since we normally believe that the asset principal also contributes to well-being, payments within the target group have been misallocated. That is, the economic well-being of the family includes the contribution of assets, but any dissaving or other benefit from assets is excluded from eligibility determination. Finally, the Supplemental Security Income asset test is valuable if the concern lies mainly with vertical target efficiency and limiting the cost of the program. A strict asset test provides a simple means for preventing anyone outside the target group from receiving benefits. The tradeoff in such a case is clear; the asset test excludes the non-needy at the expense of also excluding needy families.

Thus far, the equity discussion has assumed that all assets are treated equally and subjected to a strict asset test. In practice, this is not the case. As discussed in part 1, there are many ways to avoid the asset test. The more liquid the asset, the greater the likelihood that it will be used

to determine eligibility. These many exceptions and loopholes violate all the equity and target efficiency criteria, further complicating the asset test problem. One of the most important exclusions is an owned home which may provide substantial benefits to the owner that do not reduce SSI benefit payments. The degree of sophistication employed in converting assets to a nontested form probably varies greatly among the eligible population, perhaps directly with income. Moreover, those with larger amounts of net worth are in a better position to obtain excludable assets. Thus, not only does it become more difficult to treat equals alike, the poorest may be subjected to the strictest asset tests (affecting vertical equity). Finally, nontarget group members may be able to become eligible if they can convert assets to excluded form.

The interrelationships among transfer programs for the aged and disabled also complicate the equity issues. Since SSI fills in coverage gaps, families with equal levels of government transfers may receive them from a variety of different sources. Moreover, since only SSI and veteran's pensions are asset-tested, families may be excluded from coverage in some cases because of asset holdings or may receive full coverage when transfer benefits come from a source not subjected to an asset test. Thus, attainment of equity is further complicated when the other programs are included. This will, however, only be viewed as a major problem if, for example, Social Security (plus other non-asset-tested programs) and SSI are viewed as having equal goals. Then the concern would be the effect of government transfers (B+W) as follows:

$$\begin{cases} [(G - vL^* - O - rN - W) + W] & \text{if } N < M \\ W & \text{if } N \geq M \end{cases}$$

The higher Social Security (W), the greater is the reduction in SSI payments (a 100 percent tax after the first $20). Although up to the point where

Table 2.1. Effect of Asset Tests on Reducing SSI Eligibility

Eligible Group[a]	Percentage of families eligible by income and category who are or would be excluded by:			
	1	2	3	4
	Percent Countable Asset Test	Potential Broader Countable Asset Test	(1974-75) Housing Test	Columns 1 & 3 Combined
Aged	12.1%	15.5%	3.9%	15.5%
Disabled	2.7	4.8	3.3	5.9

[a]This group is confined to aged and disabled family heads as described in note 18.

B = 0, a family with no assets would not be better off if its payments come from Social Security instead of SSI, this is not the case for a family with assets. Since assets over the limit force B to zero, the higher is the share of total payments from Social Security, the less the family is penalized for its assets. The greater the proportion of benefits from Social Security, the less important is the asset test.

To further complicate this issue, Social Security recipients, not surprisingly, also hold considerable assets. In a hypothetical example, if Social Security were eliminated, 42.4% of the aged would be eligible for SSI. Elimination of the asset test would raise this figure to 64.1%. In other words, of the 36.5% of aged families who are ineligible for SSI because of Social Security payments, over one-half would also fail the asset test for SSI.

In general, the asset test for SSI creates strong horizontal and vertical equity and horizontal target efficiency problems by ignoring the contribution of assets below the limit and taxing severely all families with assets in excess of the limit. It does contribute to vertical target efficiency through its stringency. However, when the specific exclusions are considered, all the equity measures are adversely affected. Finally, if the non-asset-tested transfer programs are included in the equity considerations, the asset test appears even more arbitrary. Some possible solutions to these problems are discussed in section 4, after a discussion of the incentive issues (part 3).

3. INCENTIVE EFFECTS OF ASSET TESTING

Equity is not the only concern in improving asset tests; the incentives that result from these provisions also need to be explored. The application

of the resource test creates important incentives for the decumulation of assets by the aged and disabled, which may or may not be desirable. In addition, savings behavior by younger families can be altered by the very existence of a supplemental program for the disabled and aged with a stringent asset test.

Currently, the aged and disabled with low incomes are encouraged to rapidly dispose of assets (or at least to convert them to less accessible forms). If assets above the relevant limit are less than the potential SSI payment, the potential recipients will have higher posttransfer income if they do not spend down to attain eligibility. For net worth greater than SSI payments and until the point where current net assets spread evenly over the remaining lifetime of the recipient exceed total potential SSI payments across time, the aged or disabled family will be better off (in absolute dollar terms) if it more rapidly decumulates assets than if no such transfer program existed. Since few otherwise eligible families are likely to have high asset levels, the incentive to dissave rapidly will affect most families with assets.

If we expand the measure of post-transfer income to include dissaving, the following comparison can be made:

$$Y^* - B + L + O + rN + W + D^* \qquad \text{when } N < M,$$

$$Y^* = L + O + rN + W + D \qquad \text{when } N \geq M.$$

where D^* = dissaving possible for those who meet the asset test

D = unconstrained dissaving.

Dissaving can be greater for those families that have assets above the limit; hence I refer to this as unconstrained dissaving. The family is better off receiving no transfers if, in every year, there are sufficient assets to guarantee $D \geq B + D^*$. For assets less than this amount,

D can exceed $B + D^*$ for only part of the family's remaining lifetime and the family would have the incentive to deplete its assets more rapidly so that in the years when assets are over the limit, $D \geq B + D^*$. If the family strongly desires to maintain equal consumption it would tend to set $D = B$, slowing the depletion of assets. Bequest motives or other desires to hold some assets over time would also reduce the incentive for rapid decumulation. The desire to maximize total lifetime consumption, on the other hand, may encourage very rapid depletion. No time limit is placed on the decumulation of assets, so that even large amounts could theoretically be decumulated very rapidly. Thus, the rate of decumulation will depend on how the pattern of consumption affects utility. The more rapidly the depletion occurs, the greater the future burden of SSI payments. All other things equal, it is undesirable from the taxpayers' point of view for the asset test to provide strong incentives to spend down. Moreover, to the extent that families would desire to spread consumption evenly across time, the utility loss to families from foregoing one or two years of exceptional consumption may be less than the increased costs to government. Again, the form of the utility function is important in determining whether the "spend-down" incentive is undesirable.

A more difficult issue to assess is the incentive effects of asset-testing on the initial accumulation of wealth by households. If SSI is viewed by families as an insurance policy guaranteeing a minimum level of benefits at retirement or disability after savings have been exhausted, it may reduce the desire of families to save. Moreover, although SSI might encourage Social Security recipients to retire earlier by compensating them for the actuarial reduction, this change would be small and not necessitate additional saving. As a consequence, there should be no countervailing

influence to save more (as has been argued in the case with Social Security).[20] Assuming a desire for equal consumption each year, the only way that a family can substantially raise its yearly consumption at retirement or disability by saving is to accumulate such a large amount that the yearly effective annuity would be greater than the SSI payment. Using 1975 federal payment levels and assuming a 15-year annuity, SSI would have a capital equivalent of $18,379 for an individual and $27,565 for a couple. For lower accumulations, the total amount of consumption can be increased by dissaving rapidly and then drawing lower SSI payments, but this is only more desirable if the family prefers unequal consumption. This problem is rooted not just in the asset test, but also in the existence of a program that supplements income upon disability or old age. The asset test reinforces the disincentives because it disallows substantial augmentation of income with savings. Thus, not only are lower savings needed because of SSI, a certain amount of savings will exclude the family from eligibility.

In practice, the asset test is less of a disincentive for those who wish to save because of the wide range of exclusions. Homeownership by the aged is an obvious form of saving that currently escapes the asset test. Contributions to an annuity program are also possible. However, the 100% tax on unearned income may leave an SSI recipient indifferent to saving since he cannot increase his after-transfer income. One exception is that net imputed rent from an owner-occupied house is exempt from this tax. The incentive to save in such a case would result from deriving positive utility from holding a stock of net worth. Thus, while these various exceptions exacerbate the equity issue they probably tend to reduce the distortions

that arise with regard to both the accumulation and subsequent decumulation of assets. Again, the incentives may not be evenly spread among the population. Families with low resources before becoming aged or disabled may not be able to accumulate savings of sufficient size, or with sufficient regularity to take advantage of these alternative forms of net worth excluded from the asset test.

The asset test under SSI encourages a rapid depletion of existing assets by the low-income aged and disabled and probably discourages saving by those who may someday participate in SSI. The exclusions from the resource limits result in an easing of these above two problems but create incentives to hold assets in nonliquid forms. These may or may not be viewed as undesirable effects. The life-cycle consumption model plays a significant role in explaining the concerns of the potential recipient. If we agree that families desire to smooth out their consumption over their lifetimes, SSI creates barriers. If, however, families prefer to maximize total lifetime consumption regardless of the yearly pattern, the recipients may not view SSI as constraining their behavior. In this latter instance, the case for undesirable incentives must subsequently rest on the argument that SSI changes behavior in such a way as to place an unnecessarily large burden on taxpayers. If SSI creates a moral hazard, encouraging the aged and disabled to spend down their assets and live on the "dole," then the negative incentive effect is one of increased cost.

4. ALTERNATIVE APPROACHES TO ASSET TESTING

The discussion surrounding current treatment of assets for SSI eligibility suggests that some alternative approach might alleviate various problems. However, as discussed below, each of the alternatives raises

additional issues, solves some existing problems and makes others worse. While they do not specifically address all the programmatic issues, the equity and incentive consequences are explored. The final choice of a policy change turns on which of these problems areas are the more important. For example, if the primary concern is to guarantee a subsistence income for all needy individuals, we should be most concerned about horizontal and vertical equity and horizontal target efficiency. Another goal for policy might be to ensure that all nonneedy families are excluded from coverage. Such a goal implies emphasis on vertical target efficiency and the incentive effects of the asset test. Hence, this section attempts to raise the appropriate issues without singling out any one alternative as most desirable.

Total Elimination of the Asset Test (Alternative #1)

Perhaps the simplest approach to the asset problem is to totally disregard assets when determining eligibility for SSI and veteran's pensions. If the standard of well-being is based solely on current income, there would be no equity problems from such a policy change. A more comprehensive measure that incorporates assets would, however, raise a number of potentially important equity issues from ignoring assets in determining eligibility. To examine these issues we need to define the resource constraint after all transfers (again using an expanded post-transfer income definition):

$$B = G - vL^* - O - rN - W$$

$$Y^* = B + L + O + rN + W + D$$

and simplifying:

$$Y^* = G - vL^* + L + D.$$

Benefits (B) would vary with all of the income components except dissaving (D). In the earlier model, B was adjusted for all resources and the stringent asset test precluded a large D (except for one year).[21] Elimination of the asset test means that B will not vary directly with the expanded income measure (Y*) since large variations in D are now possible. Since there is no "penalty" for dissaving in the form of reduced benefits, D may accurately reflect the asset contribution to well-being. If this is so (or even if D represents a lower bound), both horizontal and vertical equity will be affected.

According to the limited estimates from the Michigan data shown in Table 2.2, 5.9 percent of disabled families and 15.5 percent of aged families eligible on the basis of income were ineligible when subjected to the housing and countable asset tests in 1974.[22] Some of these families would legitimately fall within the target group (families with low incomes and moderate assets). Others would have sufficient assets and should (by a comprehensive economic welfare measure) be denied benefits. Thus, vertical target efficiency would suffer, but by less than it might appear from the figures in Table 2.2. Total costs would also rise.

Finally, if all cash transfer programs for the aged and disabled are examined rather than just SSI, the equity issues may change. Under such circumstances the asset test appears even more arbitrary. Not only can many SSI recipients effectively avoid the test, but it is not even applied for the other program. Consequently, those most likely to be excluded from benefits are near the bottom of the income distribution. Thus even if by the elimination of the asset test some nonneedy families eventually receive SSI, families with both higher incomes and higher assets already receive Social Security. From this standpoint horizontal equity would be enhanced

Table 2.2 Changes in SSI Eligibility Under Alternative Asset Treatments

	Percentage of Categorical Group Eligible for SSI[a]	
	Aged	Disabled
By 1974 standard	23.3%	44.6%
Eliminating $25,000 housing limit (as done in 1976)	24.3	46.2
Eliminating countable asset test	26.6	45.9
Eliminating all asset tests (Alternative #1)	27.6	47.4
Raising countable asset test limit (Alternative #2)	25.1	46.7
Counting 10% of assets as income (Alternative #4)		
All assets (including home)	18.6	42.1
Liquid only	25.7	46.9

[a] See notes 18 and 22.

by eliminating the asset test, although vertical equity would still be distorted because differences in asset holdings would be ignored.

From an incentive standpoint, SSI should no longer affect the rate at which assets are depleted (so long as dissaving is not counted as current income). In fact, the only way that SSI could affect asset holdings is through the income test on asset income. In 1976, assets of $35,540 with a 6 percent yield would be necessary to disqualify an individual who receives only asset income. However, at the margin, such a treatment of assets might discourage families from depleting their assets if they have strong bequest desires or are highly risk adverse (fearing, for example, catastrophic illness).

This strategy of eliminating the asset limits obviously makes more sense for the disabled who are less likely to have accumulated assets and hence would not create vertical target efficiency problems. Moreover, the greatest deeming problems are associated with disabled children and this should reduce some of those inequities. But for the aged, it is quite possible that there are families with low incomes and high assets who should not receive benefits; in a world of scarce resources, transfers to these families may deprive more needy families of aid.

Raising the Countable Asset Test Limit (Alternative #2)

An increase in the dollar limit could be set high enough to allow most families to retain their current assets, thus leaving them free to allocate net worth over their lifetimes as they see fit. Yet the retention of an absolute limit should prevent families with large asset incomes from qualifying for SSI. The limit would still create a notch problem but fewer families would be affected. The obvious difficulty lies in determining the

appropriate limit and whether all assets—especially owned homes—ought to be treated equally. If the asset limit is high enough to avoid distorting the dissaving behavior by families, it would probably also be high enough to result in more severe vertical and horizontal equity problems between families with and without assets.

As long as a family has assets below the limit, it is implicitly assumed to have no effect on need for transfers. A new asset limit of, say, $5000 for a couple could provide a 10-year constant annuity of about $680 if the return on assets averaged 6%. Families with equal incomes but no assets would receive the same SSI payments as a family with the potential annuity of $680. From the Michigan estimates, extending the limits on countable assets to $3500 for individuals and $5000 for couples would result in increased eligibility by the aged to 25.1% and by the disabled to 46.7% of the categorical population (again see Table 2.2).

Finally, this higher limit alternative may be less desirable than totally eliminating the asset test since in addition to creating the same problems, it also may retain the inequities among different types of assets. A higher asset limit (if any at all) would be necessary for homeownership. Other resource differences as currently exist might also be retained, again raising yet another source of horizontal inequity between those with included and excluded assets.

Counting Dissaved Assets and Imputed Income from Assets as Income (Alternative #3)

This third alternative would take actual behavior on the part of families into account, implicitly assuming that only the actual consumption of assets enhances economic well-being.[23] For such an alternative, imputed income from

homeownership would also be treated as income. This measure of "real" consumption should treat various assets more evenly. The most obvious disadvantage of this alternative is the practical difficulty of measuring and verifying consumption behavior.

This alternative can also be expressed by our formula:

$$B = G - vL^{*} - O - rN - W - D$$

$$Y^{*} = B + L + O + rN + W + D$$

and simplifying:

$$Y^{*} = G - vL^{*} + L.$$

If D does capture the contribution of assets to well-being, then this treatment should satisfy vertical and horizontal equity. Benefits would increase or decrease directly with changes in D. Thus, from an equity standpoint, the appropriate indicator of economic status is again crucial. If the contribution of assets is equated with their actual depletion in any one period, then equity turns on an individual's decision. Are two people equally well-off when one has no assets and the second simply decides not to tap his or her available resources? The rate of dissaving under such a program is also likely to be distorted since dissaving would be heavily taxed. Aside from the obvious moral hazard questions, even "unused" assets may contribute to well-being through the additional security they provide. Thus, while this change should be an equity improvement over both a strict asset test and no asset test whatsoever, it may still fail to treat equals equally. By choosing to retain their assets intact, families can make themselves eligible even if they are not actually part of the target group. This would imply problems with vertical target efficiency.

This alternative creates exactly the opposite depletion incentive as for the existing asset test. Families with any possible reason for

postponing the depletion of their assets should do so, especially if dissaved income is taxed at 100%. Particularly for the disabled, other welfare benefits may expire or be reduced in the future. Thus, if disabled families desire some security and a relatively even yearly consumption pattern, they should not dissave. Bequest motives by the elderly may lead them to retain all their assets. To offset these effects, reducing the tax rate on unearned income could increase the desire to dissave. At a tax rate of less than 100%, families could raise their absolute income levels by depleting their assets, although some disincentive for dissaving would remain.

Arbitrarily Treat Some Portion of Net Worth as Income (Alternative #4)

Each year a certain percentage of total assets would be treated as income and subjected to an expanded income test, regardless of the dissaving behavior of the aged or disabled family. The percentage should generally be above the expected return on the assets—for example, 10%—and would replace property income in the income test.

This percentage conversion should improve horizontal equity; the net worth annuity approach to economic status discussed earlier suggests that a small share of assets should be apportioned each year over the remaining expected lifetime of the aged or disabled individual. While some new families would become eligible for aid, the total effect would be a net decrease in eligibility as compared to the current asset test. However, if the same assets (homes and nonliquid resources) as are currently excluded from the test were also excluded here, the number would rise. The Michigan data simulation suggests that the eligible population would fall to 18.6 and 42.1% of

the aged and disabled respectively if 10% of all assets were treated as income (Table 2.2). Partial inclusion of assets in the percentage calculation would leave 25.7% of 46.9% of the aged and disabled eligible.[24] This percentage approach would also lower the benefit payments of some families below the existing asset limit (or able to avoid the limit), since a portion of those assets would now be counted as income. Thus, total cost of SSI payments would decline at an even faster rate than the eligibility reduction.[25]

The benefit and income formulations can be recalculated to include this percentage approach as follows:

$$B = G - vL^{*} - 0 - sN - W$$

$$Y^{*} = B + L + 0 + rN + W + D$$

and simplifying:

$$Y^{*} = B - vL^{*} + L - sN + rN + D$$

where s = percentage of net assets subject to the income test ($s > r$).

By this approach benefits do not vary with actual levels of dissavings, but rather by a fixed percentage representing the contribution of assets to the family's resource constraint. As long as D exceeds $(s-r)N$, actual income will be higher than under the third alternative (the dissavings approach). Moreover, this means that D can be less than the amount taxed (sN) and still raise the income level. If sN is a proxy for a rational rate of depletion, assets are less likely to be decumulated too rapidly. Thus, the percentage (s) is important for determining incentive effects. If it is less than or equal to the rate of return on assets, it would be effectively the same as eliminating any asset test (but retaining actual and imputed asset income in the calculation of current income). Nor should the percentage be so high as to force a family to decumulate its assets too rapidly. Moreover,

if the limit is reasonable, assets such as the home could still be retained even though a certain percentage would be taxed. Thus, although there should be some incentive to dissave, it would certainly not be so great as to encourage families to decumulate assets as rapidly as with a strict asset test.

By this alternative there are also some important equity issues between the aged and disabled. Normally, disabled individuals will have longer life expectancies than their over 65 counterparts. To be consistent with the measure of economic status discussed earlier, the disabled might be legitimately subjected to a lower percentage of assets. However, too strict an adherence to different life expectancies is probably not desirable.

Since this alternative proposes to measure as income a component not previously considered, it might be legitimate to raise the income limit somewhat either by changing the tax rate or the guarantee level. This would increase the number of eligible families and somewhat offset the reduction that results from subjecting a fraction of all assets to the income test. For example, the 1974 figures indicate that raising the guarantee level to $2250 for a single individual and $3500 for a couple (from the 1974 figures of $1752 and $2628) would increase eligibility to 26.2% for the aged and 52.6% for the disabled.[26]

6. CONCLUSION

This paper discusses the equity and incentive issues surrounding Supplemental Security Income. The asset test as it currently exists is neither comprehensive, nor an appropriate gauge of need. Consequently, it creates a number of equity problems. Moreover, it encourages rapid depletion of

assets (other than an owned home) when a more gradual consumption would probably be desired by families.

The alternatives of eliminating the asset test entirely, or of raising the countable asset test limit substantially would help to prevent the too rapid decumulation of assets but would create a new set of equity problems. Treating part of assets as income provides yet another pair of alternatives. Counting actual dissaving as income--that is then taxed at a very high rate--undoubtedly discourages any depletion although it should alleviate some of the equity problems. Finally, allocating a percentage of assets to income would ease the equity problems (except perhaps between the aged and the disabled) but may again encourage an increase in the depletion of assets (to some level between the existing system and the first alternative). The first two alternatives would probably increase participation; the number eligible would rise. The last alternative, on the other hand, may, ceteris paribus, lower the number of families receiving SSI.

NOTES

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[1]Throughout this paper I present various estimates based on the Michigan survey for 1974. Families headed by aged and disabled persons have been singled out as the two "categorical" groups. Aged and disabled persons in families headed by a non-aged, non-disabled person have not been included in the empirical work because of the conceptual problems in determining eligibility and the small sample size that would result. More comprehensive data are available on the head and hence that is where the emphasis has been placed.

[2]This formula ignores the $60 per quarter disregard for income. Moreover, the analysis uses yearly figures even though SSI is calculated on a quarterly basis. The tax rate (v) on earned income is 50% and applied to earnings over $195 per quarter.

[3]The 100% tax rate applies to all unearned income, including Social Security and other pension payments. The latter payments may be viewed as income from earlier (forced) saving and hence as dissaving of assets.

[4]Unless otherwise indicated, this discussion is based on the Social Security Administration's Claims Manual (Social Security Administration 1976). Additional discussion of the application of these provisions is available from the Center on Social Welfare Policy and Law (Blong et al. 1975).

[5]The most recent Social Security Survey of the Aged also indicates that holding of nonliquid assets are positively correlated with income (Bixby et al. 1975).

[6]This assumes that there is no asset income which would change as assets are depleted. The example would still be valid if the assets did produce income, it would simply be more complicated.

[7]Elsewhere I have argued that in-kind transfers, intrafamily transfers, tax liabilities and leisure time also ought to be included (Moon 1977). Although they should be included in any such measure I have omitted the discussion here. The major additional complication would be the interrelationship with in-kind programs such as food stamps and public housing, but this was beyond the scope of this paper.

[8]See, for example, Friedman (1957) and Ando and Modiliani (1963).

[9]These could result from cessation of benefits (such as with some worker's compensation programs). In this case no current dissaving should take place. Otherwise the measure of well-being ought to be very similar to that for the aged, since both groups are unlikely to have substantial amounts of human capital. Again, this measure is intended for disabled <u>heads</u> of families.

[10]The annuity formula is based on the rate of return on assets (r) and life expectancy of the individual or family (n):

$$A = \frac{r}{1-(1+r)^{-n}} \cdot N$$

See, for example, Moon (1977) or Weisbrod and Hansen (1968).

[11]Steiner and Dorfman (1957) used this approach for defining economic status for the aged.

[12]In fact some researchers have found a strong desire among the aged not to deplete their assets. See, for example, Menchik (1977).

[13]This is not meant to imply, however, that SSI is helping all those in need. For example, some aged eligibles may not be in the lowest 23% as ranked by an expanded economic status measure. Conversely, ineligibles may be in the target group.

[14]This measure could alternately be used to indicate what percent of the target group receives benefits, but this tends to be indicated by the strict equity measures.

[15]In fact there may be a negative relationship between vertical target efficiency and the other indicators. A high income- and asset-conditioned program may be very successful at excluding the nonneedy, but only at the expense of those also excluded who are within the target group.

[16]This calculation assumes a relatively high 6% rate of return. If the return is lower, the annuity will also be lower.

[17]It could be argued that such slow dissaving is irrational behavior by an aged couple potentially eligible for SSI and hence not a substantive equity concern. However, other programs (such as tax deferred savings plans) stress the rationality of such behavior.

[18]These estimates are only suggestive of the relative magnitude of change possible. They do not allow for any behavioral changes that might be induced when the eligibility requirements are altered. The aged and disabled groups refer only to the family heads on the Michigan Survey. Other family members have not been included. Only the liquid asset and housing tests have been used to define eligibility. The other components (automobile, etc.) have not been incorporated. In order to include families who would be ineligible for federal payments but who may receive state supplementation, the income limit has effectively been raised by 20% for those who reside in states that provide supplements to the aged and disabled.

The specific estimates are calculated from three questions: the market value of an owned home; income from interest, rent and dividends; and whether the family has savings equal to 2 months income. For nonhousing assets, only a lower bound estimate is thus possible based on income generated from a 6% rate of return on assets. If this figure is too low, estimated net worth will be overstated. However, it seems more likely that the assets will be underestimated because of the inability to capture wealth that does not directly provide interest, rent or dividend income.

An additional constraint is placed on this estimate when liquid assets are needed. If a family indicates that its savings total less than 2 months income, assets are constrained to be no greater than that amount. Hence the property income based estimate is used but is subject to the 2 months constraint where appropriate. Again the problems of non-income earnings assets may bias the figures as well as the problems associated with more sensitively separating liquid from nonliquid assets.

[19]Included are property or other assets that provide a reasonable rate of return. This column does not, however, include assets otherwise tested, such as an owned home or an automobile.

[20]See, for example, work by Feldstein (1974) and Munnell (1974).

[21]Obviously when a family is spending-down its assets to become eligible, it can have substantial dissaving in any one year.

[22]These figures refer only to eligibility. Actual participation would only show the same relative changes if the newly eligible families choose to participate at the same rate as existing eligibles. Jennifer Warlick has also made similar calculations for the aged using the 1975 Current

Population Survey and different estimation procedures. She finds fewer families initially eligible for SSI, but notes a similar pattern for various changes in the asset test.

[23]Since any eligibility estimate for this alternative would depend on behavior, no estimates are possible. However, the no-asset-test figures would provide an upper bound estimate on participation.

[24]The partial inclusion refers to only those assets used in the countable asset test. The figures indicate the obvious impact of excluding the home (as well as other nonliquid assets) from the 10% calculations.

[25]The Michigan data suggests that the number of eligible aged families would decline by 20.2% if 10% of all assets were treated as income, while total benefits would decline by 23.1%. For the disabled the figures are 5.6 and 8.2% respectively.

[26]While such a change would increase the number of eligibles in 1974 over the existing program, total costs might increase by a smaller percentage or not at all since some of the families eligible under both plans would receive less under the percentage alternatives since their assets would reduce their benefit payments. See note 24.

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Income, Asset and Work Tests in Transfer Programs for Able-Bodied, Nonaged Individuals

Irene Lurie

The growing share of our population that is aged and dependent on government support raises questions about the future direction of income transfer programs for the elderly. One important question is the way in which transfer benefits should be related to current income and assets. Both of the major programs for the aged, Social Security and the Supplemental Security Income (SSI) program, are frequently criticized for failing to achieve an appropriate relationship between benefits and need. The falling replacement rate in Social Security, which is designed to favor the aged who are presumed to be the most needy, in fact helps many people who have adequate incomes from public or private pension plans or from other sources. The limit on the amount of assets which can be held by SSI recipients, a provision designed to restrict eligibility to the most needy, encourages the aged to impoverish themselves and creates what many feel are inequities among people with essentially the same need for support. These and other problems are forcing a reexamination of the way in which transfer payments might be conditioned on the needs of the elderly.

This paper complements others in the volume by providing a background for an analysis of policy options in designing transfer programs for the aged. It discusses how benefits are currently related to need in some of the larger programs for people who are neither aged nor disabled. These programs include four that are income-conditioned--Aid to Families with Dependent Children (AFDC), general assistance, Food Stamps, and Pensions to Surviving Spouses and Children of Veterans--and two that are social insurance--Unemployment Insurance and Survivors' Insurance.

In designing a transfer program to redistribute income from richer to poorer households, a measure of a household's need for transfers must be chosen. This measure can be narrowly based on the actual earnings or income of the household members, or it can be broadened by taking into account the household's assets, the potential earning capacity of its members, and/or the potential contributions from relatives, governments, or other sources.

Three of the income-conditioned programs examined here, pensions for veterans' survivors being the exception, determine need using a broad measure of a household's economic resources. These programs define income comprehensively, generally making a distinction between earnings and unearned income, with unearned income including income from assets and private and public transfers. Potential earning capacity is taken into account by imposing a work requirement on certain recipients as a condition of eligibility. Potential contributions from relatives are included in those programs that make efforts to obtain child support and alimony from absent parents or that have relative responsibility provisions. The programs generally distinguish among seven categories of assets: the home, household and personal effects, vehicles, life and burial insurance, income-producing property, income-producing liquid assets, and cash. Income-producing property includes such items as tools, equipment, livestock and real estate. Income-producing liquid assets include stocks, bonds and other negotiable assets. The two insurance programs examined here base payments solely on earnings and/or earning capacity.

The manner in which each of these programs takes a household's resources into account is discussed in detail below. Each program is examined with respect to its objectives, eligibility requirements, benefit structure,

treatment of income and assets, relative responsibility provisions, and work requirement. AFDC, general assistance, and Unemployment Insurance are the responsibility of the states. Where the states are given discretion in structuring their programs, the policies of New York State will be examined.

1. AID TO FAMILIES WITH DEPENDENT CHILDREN

AFDC is an income-conditioned program whose objective is to provide a minimum income for certain needy families with children. In order to be eligible, a family must be in need due to the death, incapacity, or continued absence from the home of a parent or, in some states, the unemployment of the father. The vast majority of AFDC families are headed by women, many of whom have been deserted or have borne children out of wedlock. As of 1976, 27 states had chosen to extend assistance to families with unemployed fathers, but these families were only 4% of all AFDC families. At the end of fiscal year 1976, 3.6 million families, containing 11.2 million people, received benefits, and benefits totalled $9.8 billion during the year (Social Security Bulletin 1977a).

AFDC is a state program and, while it is partially financed by the federal government, the states have complete control over the level of benefits provided. Each state establishes a "need standard," which is the income the state decides is essential for basic consumption items such as food, clothing, shelter, household supplies and personal care items. These standards vary by family size and sometimes by shelter costs and the age of the children. Some states supplement the need standard to take into account special needs, such as an unusual diet or transportation to a doctor.

Benefits are computed by comparing net income, to be defined below, to the need recognized by the state. Two-fifths of the states pay recipients

the full difference between net income and their total need. The other states limit payments by imposing a maximum on payments, by paying a stated fraction of the difference between net income and need, or by paying the difference between net income and a fraction of need. As of July 1976, the monthly need standard for a family of four varied from a high in the continental United States of $519 in Vermont to a low of $187 in Texas. The largest amount actually paid for basic needs ranged from $433 in Oregon to $60 in Mississippi.

Initial eligibility is limited to families whose net income is below the full need standard.[1] In addition to this income test, families must meet an asset test, which is also specified by the states, subject to a federal limit on the net worth of the recipient. Finally, certain family members must meet the work requirement imposed by the states. Both asset tests and the work requirement are discussed in more detail below.

The Treatment of Income

The Social Security Act which establishes AFDC does not contain detailed provisions concerning the treatment of income and assets. It requires that the states "...shall, in determining need, take into consideration any other income and resources of any child or relative claiming aid...as well as any expenses reasonably attributable to the earning of such income [42 U.S.C. Sec. 602 (7)]." It also requires the states to disregard the first $30 of monthly earnings and one-third of the remainder, the earnings of children in school, and training allowances from the Work Incentive program up to $30 per month. States may, at their option, permit an unspecified amount of income to be set aside for the future identifiable needs of a child.

Federal regulations (45 C.F.R. Sec. 233.20) exclude a few types of unearned income: home produce consumed by the household, loans and grants

to students for educational expenses, the bonus value of food stamps and the benefits from several other food programs, weekly incentive allowances made under Section III of the Comprehensive Employment and Training Act, and payments under a few additional small government programs. In short, almost all types of unearned income, both public and private, are counted in determining benefits.

The states are left with very little discretion concerning the definition of income or the deductions that can be made from income. Hence, New York State's definition of net income corresponds closely to the specifications of the federal laws and regulations. New York does not permit income to be set aside for the future identifiable needs of a child. Deductible work expenses are defined broadly to include income and payroll taxes, group insurance, union dues, tools, uniforms, meals, transportation, and child care (Department of Social Services, n.d.).

Most AFDC families rely on the program as their sole source of income. As shown in Table 3.1, only one family in six reports any earnings, and far fewer report other types of income.

The Treatment of Assets

Federal regulations impose a limit on the assets that can be retained by an AFDC recipient of $2000, or $8000 for a family of four. They do not state explicitly whether the limit is on gross or net assets, specifying only that resources should be "reasonably evaluated." In computing assets subject to this limit, states are permitted to exclude the home, personal effects, an automobile, and income-producing property. They are also permitted to allow "reasonable proportions" of income from businesses or farms to be used to increase capital assets so that income may be increased.[2]

Table 3.1

Sources of Nonassistance Income
of AFDC Families, January 1973

	Percentage of Families Receiving Income from Source	Average Monthly Amount Received by Families with Source
Earnings	16.3	$256
Earnings from public service employment (WIN)	.3	119
Support payments from absent parent		
Court-ordered	5.6	89
Voluntary	3.9	72
Contributions from stepparent in the home	.4	62
Contributions from other persons in the home	.9	54
Social security	4.4	126
Unemployment insurance	.4	158
Veterans benefits	.9	91
Other benefits or pensions	.5	137
Other cash income	1.1	54
Income in kind to which a money value is given	3.0	31
Any of above	33.1	180

Source: Department of Health, Education, and Welfare, Social and Rehabilitation Service (1973, p. 6).

The federal regulations do not prohibit the states from imposing more stringent asset tests, in contrast to the limited discretion given the states in calculating net income. Hence, there is considerable variation in the states' limits on total assets as well as in their treatment of homes, automobilies, income-producing property, life insurance, and other forms of real and personal property.

New York State requires that all "available resources" be applied toward meeting the needs of recipients.[3] In other words, no general reserve of assets can be held. But New York State distinguishes among four broad categories of assets--real property, life insurance, and liquid and nonliquid personal property--and permits certain items within some of these categories to be disregarded.

No limit is placed on the value of real property used as a home and home ownership cannot, in and of itself, make someone ineligible for assistance. But the state does give local social services commissioners the authority to require, at their discretion, that recipients assign their home to the local commissioner.[4] Assignment means that the commissioner places a lien on the property equal to the amount of assistance paid. Unless the recipient repays the assistance, the lien remains in effect until the home is sold, at which time the proceeds of the sale are used to reimburse the government. Until sold, the home remains private property and on the tax rolls. In effect, the recipient receives an interest-free loan equal to the amount of assistance paid or the value of the home, whichever is smaller.

Actual practice varies considerably, and the State Department of Social Services has not "made an issue of it," according to one state official. Some local commissioners do not require assignments because they lock people into living in the same home and frequently take a long time to redeem. But

others feel that the climate surrounding welfare requires that homes be assigned in exchange for assistance.

It is relevant to note that New York State bases its payments for shelter costs on the amounts actually spent by recipients, up to a maximum. Included as a reimbursable expense is the amortization of the mortgage on a recipient's home. This provides added justification for assigning the home to the welfare agency.

Each recipient must be permitted to retain an insurance policy having a face value not exceeding $1000, provided that the cash value of the family's policies do not exceed $500 for any individual or $1000 for the family.[5] When the value of the insurance exceeds the limits, the recipient is generally required to convert to a less expensive policy and use the cash received to meet his current needs.[6]

At the discretion of the local commissioner, however, a policy above the limits can be assigned to the local agency, which then becomes the beneficiary. Examples given in the regulations of when assignment is appropriate are when the recipient has a drastically reduced life expectancy or when disability benefits are being received or will be received within a reasonable length of time. In these two cases, insurance benefits are being received or will be received shortly, and it would be uneconomical for the recipient to be required to reduce the value of the policy. When a policy has been assigned to an agency, the agency must pay the premium unless it elects to take the paid-up value of the policy. The benefits of an assigned policy are to be used first for burial expenses and then to reimburse the agency for the assistance paid. However, if a deceased recipient is survived by relatives for whom he has been legally responsible and who are, or are liable to become, public charges, the benefits may be given to these relatives rather than being used to reimburse the agency.

While local commissioners are given some discretion, it is far less than in the treatment of real property. In practice, there is little variation in their treatment of insurance, which was described by a state official as being "pretty tough."

New York State distinguishes between personal property that is "...essential to the health, living arrangements, or to the production of income... [Department of Social Services, p. F-5]" and that which is nonessential. Cash bank accounts, and liquid assets such as stocks, bonds, and mortgages are presumed to be nonessential. In order for a family to become eligible for assistance, all securities must be liquidated. The family's cash assets are then counted as income in determining eligibility and the amount of payment. For example, if a family has a need standard of $400, no current income, and liquid assets of $300, the family is eligible and receives a payment of $100. Liquid assets are thus taxed at 100 percent. In contrast, many other states deny eligibility to families with assets above some limit. This loss in benefits when assets exceed the limit is in effect a tax on the first dollar of assets above the limit at a rate well above 100 percent.

No reserve of liquid assets can be held. If a family accumulates a reserve from its AFDC benefit, earnings or other income, it is generally counted as income in determining its benefit. An exception is permitted when a reserve is accumulated to purchase items considered to be basic needs, such as a washing machine, furniture, or clothing.

Nonliquid personal property, such as furniture, clothing, jewelry, automobiles, farm implements, and business equipment must be analyzed to determine its essentiality. In practice, recipients are permitted to keep most types of personal property, including such items as engagement rings and televisions. The major problem arises in determining whether automobiles,

snowmobiles, and boats are essential. Automobiles are generally considered to be essential in rural areas but nonessential in urban areas where public transportation is available. If a recipient does not sell a nonessential car within 30 days, the case is closed for failure to cooperate. Most local agencies are strict in their treatment of boats and snowmobiles, considering them essential in only a few circumstances, such as for families living on islands and in places that can be reached only by snowmobiles in winter.

Trust funds up to $1000 can be held for a child under age 21. An application to the court must be made for the release of trust funds if they exceed $1000, although if such funds represent the proceeds of a personal injury award they should be used first to pay for costs related to the injury rather than for basic maintenance costs.

New York State requires that all income and assets be verified in determining eligibility and outlines the procedures to be used in obtaining information.

While the complexity of asset tests makes it difficult to compare one state's with another's, New York's appears to be relatively stringent. Many states allow recipients to hold a limited amount of personal and real property other than the home and let them keep these assets in whatever form they choose. Many specifically permit recipients to hold liquid assets up to some limit. The majority of states permit recipients to own an automobile even if it is not required for employment, although some limit its value. While New York is with the majority in placing no limit on the value of a recipient's home, it is one of only three states that place liens on real property. Forty-one states make no effort to assign property, impose liens or otherwise recover legally paid assistance. New York and 20 other states have no provisions disqualifying an applicant who has transferred property in order to obtain

assistance (U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service 1974).

Table 3.2 presents information on the amounts of assets owned by AFDC families. A comparison of these data with the asset limits imposed by the states indicates that most recipients' assets are well below the permitted maximums.

Asset tests do not appear to be difficult to administer. The AFDC Quality Control program periodically reviews a sample of cases to determine if eligibility and payments were correctly determined. The Quality Control review for January-June 1976 found that errors had been made in 22 percent of the cases. But of all the cases with errors, those involving the treatment of assets amounted to only 3.4 percent.[7] Of course, the low error rate stems in part from the small amounts of assets owned by recipients.

Relative Responsibility Provisions

Court cases over the past decade have sharply limited the individuals who can be held responsible for the support of AFDC children. The only individuals who are now held responsible are natural or adoptive parents, and stepparents who are legally obligated to support children under state laws of support applied to the general population. Other relatives or non-relatives living outside or in the home cannot be held responsible for support and it cannot be presumed that they are supporting the family. This provision includes children in the family as well. If, for example, one child has earnings, Social Security, or child support that he does not share with the rest of the family, the family must have the option of ignoring him in the calculation of their income and need for assistance. However, actual contributions

Table 3.2

Amount of Assets Other Than the Home
of AFDC Families, January 1973

Amount of Assets	Distribution of Families by Amount of All Assets Other Than Home[a]	Distribution of Families by Amount of Liquid Assets	Distribution of Families by Amount of Other Personal Property[b]
0	76.3	89.8	80.7
$ 1 - 99	4.3	4.7	2.2
100 - 199	3.5	.8	3.3
200 - 299	2.5	.4	3.4[e]
300 - 399	1.6	.4[c]	1.2[f]
400 - 499	1.0		
500 - 999	2.4	.3[d]	2.1
1000 or more	1.7		1.4
unknown	6.6	3.6	5.7

Source: Department of Health, Education, and Welfare, Social and Rehabilitation Service (1973, pp. 24-28).

[a]Assets held (owned or being bought) regardless of whether items are exempted by the state.

[b]Household furnishings excluded.

[c]$300 - 499

[d]$500 or more

[e]$200 - 349

[f]$350 - 499

from all individuals, whether legally obligated to support the family or not, must be included in income.

Since August 1975, federal law has required the states to have a program for locating absent parents and obtaining child support from them (42 U.S.C. Sec. 651-59). Recipients must assign any rights to child support to the state, which must make efforts to secure such support from absent parents. The payments collected are used to reimburse the states for the cost of assistance, and can only be paid to the family, and thereby increase the family's income, if they are greater than the amount needed to reimburse the state and not in excess of the support required under a court order. Support in excess of that ordered by the court is used to reimburse the state for past assistance payments.

New York State established the Parent Locator and Support program in August 1975 as required. In the first year of operation, New York City had spent $18.10 million on the program and had collected $5.7 million in support payments. Other areas of the state had spent $4.6 million and collected $20.6 million, so that the program in the state as a whole paid off. The poor experience in New York City was attributed to start-up problems and staffing difficulties. By the end of 1976, the program was reported to be breaking even in New York City (New York Times 1977).

The Work Requirement in AFDC

Federal law requiring the states to impose a work requirement as a condition of AFDC eligibility contains two basic provisions: recipients must register for the Work Incentive program (WIN) unless they are exempt, and non-exempt recipients must be willing to participate in it.[8] WIN is a manpower program, designed specifically for AFDC recipients, which provides training, subsidized employment opportunities, and direct placement in an "appropriate" regular job.

Registration for WIN occurs at the time of application for AFDC. When an individual applies for assistance, the welfare agency determines whether the applicant is in an exempt category. If not, the individual is required to register with the WIN agency, which then informs the welfare agency that eligibility determination can be completed. An eligible individual is interviewed by the welfare and WIN agencies to develop a plan leading to employment. If WIN services are available and the necessary supportive services can be arranged, the individual then enters the program.

The definition of "appropriate" work and training makes no reference to an individual's skills or previous earnings. The criteria instead specify minimum standards: the individual must have the capability to perform the job; wages shall meet the federal or state minimum wage or the prevailing wage for similar work and in no case shall be less than three-quarters of the federal minimum wage; hours shall not exceed those customary to the occupation; the work shall meet applicable health and safety standards; and no one must accept a job that is vacant due to a labor dispute or that is contrary to the rules of a union to which the individual belongs. Commuting time shall not normally exceed two hours, and day care meeting federal standards must be available. Appropriate work may be temporary or permanent, full- or part-time.

Few AFDC recipients who are required to register refuse to do so or to participate in the WIN program. But less than 10 percent of the recipients registered for WIN at some time during fiscal year 1975 completed the program and less than half of these left welfare. While there is some evidence that the increase in earnings due to WIN is greater than the cost of the program, the reduction in welfare expenditures is less than the cost (Pacific Consultants 1976).

2. GENERAL ASSISTANCE

General assistance (GA) programs provide benefits to people who have fallen through the "sieve" of the income maintenance system: those who are eligible for neither the social insurance programs nor the federally funded income-conditioned programs. Because they are designed for the needy who have failed to qualify for all other programs, and who would be destitute without general assistance, eligibility is not restricted to people with special demographic characteristics. However, some states explicitly exclude people eligible for AFDC and SSI.[9]

Programs of general assistance are financed and administered by the states and/or localities, and the absence of any federal standards leads to wide variation in many aspects of program design. Some state programs are very similar to AFDC, while others are quite different and often less generous. Some states, for example, provide assistance not in cash but in the form of vendor payments to the suppliers of goods and services; others limit the duration of benefits or only pay benefits to meet emergency needs. In some states, the benefit guarantee is lower than in AFDC (U.S. Congress, Joint Economic Committee 1974).

The meager data available suggest that the income test applied in GA is stricter than that in AFDC. In 1969, only six states reported any income disregards. Ten states reported that "all income" is taken into account, but the remaining states did not report on a definition of income. A study (U.S. Congress, Joint Economic Committee 1974, p. 24) of 40 states in 1972 found that only two used the "$30 and one-third" disregard required under AFDC and that few states permitted recipients to deduct <u>all</u> work expenses.

In 1969, 23 states described their asset limits as being generally the same as those under the federally funded assistance programs; 14 states described the limits as more restrictive, and 1 as less restrictive. No provisions were reported by 13 states. Three-fifths of the states had no provisions for assignment of property, liens, or other recovery of assistance paid. The remaining states provided for recoveries from the estate of the recipient, although this was not always mandatory; 9 states secured the claim by a lien or assignment of property.

The responsibility of relatives to support GA recipients varies widely among the states. In 1969, 22 states did not report having any relative responsibility provisions; if they held even spouses and parents responsible, they did not report so to the federal government. Fifteen states reported holding spouses and/or parents responsible, and 7 states in addition held adult children responsible for their parents. The remaining states held a variety of relatives responsible, including grandparents, grandchildren, siblings, and "relatives in the county."

The use of work requirements also varies widely. Nineteen states gave assistance only to unemployable people, for whom such a requirement is unnecessary, although a few of these extended aid to employables in emergencies. Twelve states went to the other extreme and assisted people who were fully employed but needed income supplementation. Of these 12 states and the other 20 that aided employables, 22 required that recipients either register with the employment service, accept assignment to a work project, or accept "available employment." The remaining 10 reported no type of work requirement.

New York State's general assistance program, known as Home Relief, is similar to its AFDC program in most respects (Department of Social Services, n.d.).

For our purposes, however, there are a few significant differences in the income and asset tests and in the work requirement. First, Home Relief recipients are not permitted the "$30 and one-third" earnings disregard. Instead, they are permitted to deduct $30 of earnings per month, provided their employment or increased earnings occurred subsequent to participating in a training program to which they had been referred. They are also not permitted to deduct work expenses as incurred, but are subject to a schedule and a maximum. Second, Home Relief applicants can be denied assistance if they transferred property within one year of application, while AFDC applicants are not subject to such a restriction. Finally, employable Home Relief recipients can be required to "work off" their aid through public employment.

3. THE FOOD STAMP PROGRAM

The Food Stamp program subsidizes the purchase of food so that low-income households will have the opportunity to obtain a nutritionally adequate diet. Eligibility and benefits depend on a household's income, and eligibility depends as well on meeting an asset test and a work requirement. The income test, asset test, and work requirement, which will be discussed in detail below, are the sole eligibility requirements which households must meet. This means that the Food Stamp program is the only federally funded income maintenance program that is not conditioned on some characteristic of an individual or family such as age, disability, unemployment, veteran status or the presence of children.

A household's food stamp benefit is the difference between its allotment of stamps and the price it pays for them. The allotment varies only by family size, increasing from $50 a month for a single person to $298 for a eight-person household and by $38 for each additional household member.[10]

The purchase price is zero for households with very low net incomes, and generally increases by $3 for every $10 increase in net income up to a maximum. Numerous and relatively large deductions are permitted in calculating net income, as will be described below. In 1976, a monthly average of more than 18 million people participated in the program, which cost about $5.9 billion (Congressional Budget Office 1977).

The Treatment of Income

The Food Stamp Act does not state how income and assets are to be treated in determining eligibility and payments, but specifies only that participation should be limited to households "whose income and other financial resources are determined to be substantial limiting factors in permitting them to purchase a nutritionally adequate diet." It gives the Secretary of Agriculture responsibility for prescribing "the amounts of household income and other financial resources, including both liquid and non-liquid assets, to be used as criteria for eligibility." The temporary eligibility of victims of disasters is to be determined without regard to their income or financial resources (7 U.S.C. Sec. 2014). While the states administer the program, they must adhere to federal laws and regulations in determining eligibility and benefits.

The federal regulations (7 C.F.R. Sec. 271.3 (c)) define income quite comprehensively, including most cash income from private and public sources. Excluded from income are the earnings of a child who is under age 18 and a student, income in kind except for the value of housing provided by an employer up to $25 per month, all loans except those for educational support, infrequently or irregularly received income up to $30 per quarter, payments under a few relatively small government programs, and nonrecurring lump-sum payments

such as insurance settlements, inheritances, and income tax refunds. These lump-sum payments are treated as assets.

Deductions from income are considerable, averaging about $74 per household in September 1975 (Congressional Budget Office 1977, p. 46). The largest is the deduction for shelter costs in excess of 30% of a household's monthly income after all other deductions, which provides some regional cost of living adjustment in an otherwise uniform federal program. The others permitted are 10% of a household's earnings or training allowances up to a deduction of $30 per month, mandatory payroll deductions such as income taxes and union dues, child care or adult care expenses incurred when working or in school or training, tuition and fees of educational institutions, medical expenses in excess of $10 per household, unusual expenses associated with disaster or casualty losses, and court-ordered support and alimony payments.

The increase in the purchase price of $3 for every $10 increase in net income implies a marginal tax rate on net income of 30%. The 10% earnings deduction up to $30 per month has the effect of reducing the marginal tax rate on the first $300 of monthly earnings by three percentage points below the rate applied to net unearned income. In contrast to AFDC, which taxes unearned income at or near 100% but reduces the marginal tax rate on earnings to 67%, food stamps provides little special incentive for recipients to increase their earnings.

Most food stamp households are poor or near-poor and many are dependent on other government transfer programs. In September 1975, 77% of food stamp households were poor and 90% had incomes below 125% of the poverty line (U.S. Senate, Select Committee on Nutrition and Human Needs 1976, p. 46). Table 3.3 shows their sources of cash income.

Table 3.3

Sources of Income of Food Stamp Households, September 1975

	Percentage of Families Receiving Income from Source	Average Monthly Amount Received by Households with Source
Earnings	22.4	$368
Self-employment	1.2	156
Roomer/boarder	2.2	72
Student aid	.8	166
Railroad retirement and other pensions	.9	180
Social Security	21.4	177
Supplemental Security Income	17.1	119
Aid to Families with Dependent Children	41.7	243
General Assistance	8.2	165
Veterans benefits	3.4	123
Other	18.7	169
Any of above	97.0	---

Source: U.S. Senate Select Committee on Nutrition and Human Needs (1976, p. 41).

The Treatment of Assets

Federal regulations limit eligibility for food stamps to households that have no more than $1500 of assets, or no more than $3000 of assets in the case of households with two or more members when at least one member is age 60 or over (7 C.F.R. Sec. 271.3c). Assets are given their fair market value less encumbrances. All liquid and nonliquid assets must be counted with the exception of a home and lot "normal to the community,"[11] household goods and personal effects, one vehicle used for household transportation and any other vehicles necessary for employment, income-producing property, the cash value of life insurance policies and pension funds, assets such as irrevocable trust funds whose cash value is not accessible to the household, and a few other small items. The states cannot apply any public assistance rule that disqualifies an applicant who has transferred property in order to become eligible for assistance.

A household's food stamp bonus is not reduced due to assets below the $1500 or $3000 limit, but is eliminated when assets exceed the limit. Hence, assets below the limit are taxed at a rate of zero, while the first dollar of assets above the limit is taxed at a rate well above 100%. The amounts of assets owned by food stamp households are shown in Table 3.4. (See also Beebout, et. al, 1976.)

Verification of Income and Assets

Income and deductions must be verified when eligibility is determined initially and when it is periodically redetermined. Assets must be verified only to the extent that the information furnished by the applicant is unclear, incomplete, inconsistent, or otherwise raises doubt. In New York State, income and deductions are almost universally verified. Assets are fully vertified in only a minority of cases.

Table 3.4

Amount of Nonexempt Assets of Food Stamp Households
Not Receiving AFDC or SSI, September 1975

Amount of Assets[a]	Households Containing no Elderly Persons	Households Containing One or More Elderly Persons
0	68.3%	63.7%
$1-100	17.6	13.4
101-500	9.0	9.7
501-1000	3.2	6.1
1001-1500	1.8	4.8
1501-3000	.2	2.4
3001 or more	less than .1	0
Total	100.0	100.0

Source: U.S. Senate Select Committee on Nutrition and Human Needs (1976, p. 71).

[a]Excludes assets exempt under federal regulations, such as the home, one car, life insurance, income producing property, and personal effects.

Quality Control reviews of decisions made in determining eligibility and the size of the bonus suggest that the asset test is not cumbersome to administer. A review in January-June 1976 estimated the number of food stamp households that were either ineligible or receiving more benefits than they were entitled to. Of these housholds, only 6.2% were in error due to the asset test.[12]

The Food Stamp Work Requirement

Applicants for food stamps must register for and accept suitable employment unless they have good cause to refuse it. Like AFDC, many recipients cannot be expected to work and hence are exempt from the work requirement.[13] The exempt categories under food stamps are broader than under AFDC, perhaps reflecting the generally larger benefits paid under the latter program. For example, food stamps exempts mothers with children under 18 years rather than 6 years, part-time students rather than full-time, alcholics and narcotics addicts, and people working 30 hours a week. Strikers must register, but they are eligible for food stamps whereas they are ineligible for AFDC in most states.

Nonexempt applicants complete the work registration form at the welfare agency when they apply for food stamps and at least once every six months thereafter. The form is then forwarded to the local employment service office. The employment service can call recipients in for counseling, testing, referral to training and jobs, and other employment services. But unlike WIN, which devotes significant amounts of resources to increasing the employability of AFDC recipients, the Food Stamp program provides neither supportive social services nor specialized employment services. The employment services provided are at best the same as those received by Unemployment Insurance recipients, and there is some evidence that food stamp recipients receive less.[14]

"Suitable" employment is defined in two ways. For the first 30 days after registration, a recipient can restrict himself to his major field of experience. Because the work referral activity is performed by the employment service, food stamp recipients are essentially subject to the Unemployment Insurance definition of suitability for these first 30 days. After this period, the definition of suitability is similar to the minimum standards under WIN, although recipients may be required to accept jobs paying as little as $1.30 per hour.

Virtually all nonexempt recipients do in fact register for work and compliance with the work requirement is high. However, it is not very effective in increasing employment. In fiscal year 1976, the employment service referred 510,337 persons to jobs, or 16% of those registered; 243,325 persons, or 7.6% of registrants, were actually placed in jobs. The wages of people placed were relatively low: over 50% earned less than $2.20 an hour and only 11% received $3.10 or more.[15]

4. PENSIONS TO SURVIVING SPOUSES AND CHILDREN OF VETERANS

Pensions to Surviving Spouses and Children of Veterans is an income-conditioned program designed to provide a minimum income to certain widows, widowers, and children of deceased veterans. The program was changed significantly in 1960, and people participating at that time have the option of receiving benefits under the old or the new laws. The new law will be described here, for two reasons. First, of the 1.2 million recipient households in 1976, 94% were receiving benefits under the new law. Second, benefits under the old law are determined in a very simple manner and are less interesting for our purposes. Survivors are eligible if their net income is below a certain level, and they receive a flat payment which does not vary with income. There is no asset test.

Under the new law (P.L. 86-211 1960), eligibility is limited to survivors of veterans who were in the active service for 90 days or more during wartime or incurred a service-connected disability. A widow[16] is eligible regardless of whether she has children, but loses her benefits if she remarries. No work test is applied. A child remains eligible if his parent becomes ineligible due to remarriage or failure to meet the income or asset test.

A major distinction is made according to whether a widow receives benefits or whether only children receive benefits. An income test is always applied in determining eligibility but benefits are scaled to income only when a widow receives benefits. If only the children in the household are eligible, benefits are a flat amount. As of January 1977, the limit on net income was $3540 for a widow without children, $4760 for a widow with children, regardless of the number of children, and $2890 for each child whose mother is not eligible. In determining the eligibility and benefit of a widow and her children, the income and assets of the children are not taken into account.

If only children are eligible, monthly benefits are a flat $57 for the first child plus $24 for each additional child. The benefit for a widow with no net income is $125, plus $24 for any and each child. The benefits of a widow without children are reduced at a rate that increases with income from 0 to 72%. The benefits of a widow with children are reduced at a rate that rises from 0 to 60%, but then falls to 0 at an income of $3700 and remains at 0. At this income level, the benefits paid to the family are equal to the flat benefits that would be paid to the children if their parent were not eligible. Whenever the benefit paid to a widow and her children is less than the benefit that would be paid to the children alone, the family receives the higher benefit. Hence the program minimizes the incentive for family splitting. This also means that, in effect, no relatives are held responsible for each other, not even parents for children.

An annual accounting period is used. In November, adult recipients are mailed an income questionnaire that asks the income they received during the year and the amount they anticipate receiving the next year. Benefits are adjusted effective January 1 based on anticipated income for that year. If recipients receive less income than they anticipated, their benefit is increased the next year to pay them retroactively for the short-fall. If recipients receive more income than they anticipated, their benefit for the next year is not reduced to recoup the excess benefits paid. Benefits are only recouped if there is evidence of fraud. When a recipient continuously underestimates anticipated income, the benefit is based on a higher amount than is estimated or is not paid until the end of the year. Children are not asked to report their income each year, under the presumption that it is stable.

The Definition of Income

Legislation (38 U.S.L. Sec. 503) and regulations (38 C.F.R. Secs. 3.260-3.262) provide a detailed definition of net income. The earnings of adults and most income from property are counted, regardless of whether the income is in cash or kind. No deductions from earnings are made for taxes or work expenses. Excluded are the earnings of children, the rental value of owner-occupied housing and dividends from commercial insurance. Gifts and inheritances are counted as income if they are in the form of money, but excluded if they are less liquid forms of property. Only 90% of Social Security benefits, other public or private pensions, annuities, and commercial life insurance proceeds are counted as income. Completely excluded from income are SSI, AFDC and other public or private relief or charity, Veterans' Compensation, Social Security lump-sum death benefits, the value of maintenance (in a rest home, for example), and payments under some relatively small government programs. Medical expenses in excess of 5% of annual income can be deducted.

Data are not available on the total income of recipients or the sources of their incomes. Because the benefits of a widow are calculated without regard to the income of her children and the benefits of children can be calculated without regard to the income of their mother, there is effectively no limit on a household's total income.

The Treatment of Assets

The asset test bears little resemblance to the asset tests in the other programs described here. Eligibility is denied people whose net worth is "...such that under all the circumstances, including consideration of income, it is reasonable that some part of [it] be consumed for the survivor's maintenance [39 U.S.C. Sec. 543]." Net worth is defined as the market value, less encumbrances, of all real and personal property except the home, a reasonable lot, and personal effects suitable to the claimant's reasonable mode of life. In determining whether some of net worth should be consumed, consideration is given to the claimant's income, life expectancy, and number of dependents; whether the property can readily be converted into cash; and the potential rate of depletion, taking account of unusual medical expenses (38 C.F.R. Sec. 3.263).

There is no dollar limit in this asset test and considerable discretion must be exercised in implementing it. Table 3.5, which presents information on the assets of recipients, suggests that the test is administered liberally. While most recipients have no assets, there are some with very large amounts.

Verification of Income and Assets

In most cases, filing an application and a yearly income statement is done through the mail. In the absence of contradictory or obviously incorrect

Table 3.5

Amount of Assets of Beneficiaries of Pensions to Surviving Spouses and Children of Veterans, June 1976

Amount of Assets[a]	Distribution of Cases[b]
0	61.3%
$ 1 - 1,000	19.9
1,001 - 2,000	4.8
2,001 - 3,000	2.9
3,001 - 4,000	2.0
4,001 - 5,000	1.8
5,001 - 10,000	4.8
10,001 - 20,000	2.0
20,001 - 30,000	.3
30,001 - 50,000	.1
50,001 - 75,000	.02
75,001 - 99,000	less than .01

Source: Veterans' Administration.

[a]Assets other than the home and personal effects.

[b]A case can be a widow(er), a widow(er) with children, or children whose eligibility and benefits are calculated without regard to the income of a parent.

information, the survivor's statements are accepted without question. Very rarely are formal investigations or compliance surveys conducted.[17]

5. UNEMPLOYMENT INSURANCE

Unemployment Insurance is a non-income-conditioned program designed to replace the earnings of unemployed workers. Because UI programs are operated by the states under relatively few federal constraints, eligibility and benefits vary considerably. Eligibility is limited to people with recent work experience and is defined in terms of weeks worked and/or income earned in the year or so before unemployment began. Benefits are based on the wages earned in the previous year and increase with past wages up to a maximum. Ten states adjust for the greater needs of larger families and increase benefits for claimants with dependents or, in one state, increase the maximum on benefits. The maximum ranges from $63 per week in Texas to $165 in Connecticut (U.S. Department of Labor, Unemployment Insurance Service 1976).

Claimants are permitted to engage in a limited amount of work without losing their status of being unemployed. Most states exempt a specified amount of earnings and tax the rest at 100%, but a few states tax wages at a rate between zero and 100%. Neither the family's total income nor their assets are taken into account in determining eligibility or benefits, but eligibility does depend on meeting a work requirement.

The Unemployment Insurance Work Requirement

The essence of the work requirement imposed by the states is that claimants must be "able" to work, "available" for work, and must accept "suitable" work unless they have good cause to refuse it.[18] As a demonstration of their availability for work and as an aid in their finding work, claimants must

register for work with the employment service. The administration of the work requirement is fraught with complexity, since the meanings of "able," "available," and "suitable" must be broad enough to accommodate the enormous variety of labor force experience and yet restrictive enough to maintain the integrity of the program.

Availability for work is, essentially, a requirement that the worker be willing and able to work. While his willingness cannot, of course, be observed directly, an indication of willingness can be obtained from examinin his employment history, the circumstances surrounding the separation from his last job, and his response to an offer of suitable work. In 34 states, a claimant is required to actively search for work and evidence of this search demonstrates his availability.

Because Unemployment Insurance is not for the purpose of protecting workers against loss in wages caused by illness or disability, eligibility is restricted to people who are able to work. In general, a person must be able to perform some service which is usually done for hire and do so under normal working conditions. However, the worker need not be fully competitive with able-bodied workers, nor must the work he is able to do be his most recent or customary work. In the case of workers whose physical or mental condition is stable, recent employment is generally accepted as a good indication of ability to work.

The requirement that claimants accept suitable work unless they have good cause to refuse it serves several purposes. It protects workers from having to accept jobs that pose too great a risk to their health, safety or morals, or for which they are not physically fit. Second, suitability depends on the worker's prior training, experience, and earnings, and the requirement thus enables an unemployed worker to hold out for a job which

is comparable to his previous one. As the period of a worker's unemployment lengthens or if the prospects for local work in his customary occupation appear dim, the range of suitable work is generally broadened.

Compliance with the work requirement is good, at least as measured by available data. In 1975, a year that saw 22.6 million new spells of insured unemployment, 1.1 million workers were denied benefits because they were judged not able and available, and only 71,000 workers were denied benefits for refusing suitable work. However, a worker who is in good standing with regard to the work requirement may not actually be able, available, or willing to accept suitable work. He may meet the legal requirements only because he is not faced with a situation that tests him, such as a job offer. The high unemployment rate in 1975 suggests that many claimants could not be subject to a stringent test.

6. SURVIVORS' INSURANCE

Old Age, Survivors, and Disability Insurance is a non-income-conditioned federal program designed to replace the earnings of workers who have retired, died, or become disabled. It pays benefits to four groups of nondisabled survivors: widows and widowers age 60 and over, parents age 62 and over who received at least one-half of their support from their deceased child, children under age 18 or ages 18 to 21 and attending school full-time, and parents of these children. The last two groups of survivors are of interest here. They are eligible if the deceased parent had worked in employment covered by OASDI long enough to become either "fully" or "currently" insured. At the end of 1975, 2.7 million nondisabled children and .6 million of their parents were in current-payment status as survivors of deceased workers.

They comprised 10% of the 32.1 million people in current-payment status under OASDI (Social Security Bulletin 1977b).

The benefit for survivors is equal to .75 of the deceased worker's Primary Insurance Amount for each child and parent, up to a family maximum The Primary Insurance Amount is a rather complex function of the worker's earnings. Beginning in June 1977, it ranged from $108 to $576 per month, and the family maximum ranged from $162 to $1009.[19] Neither the family's total income nor their assets are relevant in calculating their benefit, and no work requirement is imposed. However, the earnings of parents and children are taken into account. As of January 1977, benefits are reduced by $.50 for each dollar of annual earnings above $3000; although regardless of annual earnings, monthly earnings below $250 do not result in a loss of benefits.[20] Only the benefits of the family member with earnings are reduced, and other family members continue to receive their full benefits.

7. SUMMARY

In comparing the programs with each other, it is striking how their provisions reflect the status and political power of the recipients. AFDC and GA recipients are probably the most stigmatized and least powerful, while the survivors of veterans benefit from both public sympathy and strong veterans' lobbies. It is significant that the risks covered by the social insurance programs, which contain no means test, are those faced by all employees.

Nowhere is this better seen than in the asset tests, which are most severe in AFDC and GA and most liberal in pensions for survivors of veterans. Some states prohibit AFDC and GA recipients from holding any reserve of

liquid assets, and those which permit liquid reserves allow relatively modest amounts. Many states limit the value of a home, car, and life insurance or otherwise restrict the form in which assets are held. The Food Stamp program is somewhat more liberal. It completely exempts those assets that are most essential, such as a home, car and income-producing property. Recipients are permitted to hold $1500 or $3000 of assets in whatever form they choose, including cash. The survivors of veterans are subject not to a stated limit on assets but rather to a broad set of guidelines which appear to be liberally administered.

Pensions for Survivors of Veterans is also the most generous in its treatment of unearned income. Ten percent of Social Security benefits, other public or private pensions and annuities are excluded from income, and the benefits from income-conditioned programs are completely ignored. The exclusion of children's income in calculating a widow's benefit and the exclusion of the widow's income in calculating the children's benefit means that the program is not strictly income-conditioned. AFDC, GA, and food stamps, in contrast, define unearned income quite comprehensively. AFDC and GA generally tax unearned income at or near 100%, while food stamps applies a tax rate of about 30% to all net income.

The provisions to encourage work effort follow the same pattern. AFDC exempts fewer recipients from the work requirement than does food stamps and, unlike food stamps, makes no reference to an individual's prior experience in determining what type of a job he must accept. The survivors of veterans are not subject to any work requirement. In contrast, the earnings of AFDC recipients are treated most generously and those of veterans' survivors least generously. AFDC permits more types of deductions for work expenses than does food stamps and lowers the tax rate

on earnings from 100% to 67%. Food stamps deducts 10% of earnings up to $30 per month and taxes the rest at the 30% rate applied to other income. Pensions for veterans' survivors permits no deductions for work expenses and taxes earnings at the same rate as unearned income. It may seem anomalous that AFDC recipients are treated more liberally than the survivors of veterans. However, the treatment of earnings by AFDC is not motivated by generosity or notions of equity, but by a desire to encourage work effort.

In designing income maintenance programs for the aged, relatively less attention needs to be paid to the problem of maintaining work effort. Indeed, Social Security contains a retirement test rather than a work requirement. Programs for the aged must be concerned primarily with the way in which benefits are related to unearned income and assets. This is not the place for a systematic appraisal of the ways in which income transfers might be conditioned on the income and assets of the aged, which is the focus of several other papers in this volume. But this review of programs for the nonaged points to one choice that is relevant in discussing alternatives to the existing programs for the elderly. This is the choice between designing programs so as to restrict aid to the most needy and designing programs to be equitable.

With the exception of pensions for veterans' survivors, the income-conditioned programs are designed to restrict aid to the most needy in order to minimize the number of recipients and cost. This is done by taxing unearned income at a high rate and imposing a low limit on assets. SSI, the largest income-conditioned program for the aged, is also designed to restrict benefits to the most needy. It, too, taxes unearned income at a high rate and limits the ownership of assets.

The high tax on unearned income in SSI is criticized as inequitable because it leaves people with income from Social Security and pensions only slightly better off as a result of contributions made during their working years. Critics of fixed asset limits argue that they reduce the incentive for the nonaged to save and encourage the aged to impoverish themselves by consuming their assets. Fixed limits also create inequities between people with assets just below and just above the limit and between people with labor income and those with actual or imputed income from property.

It has been argued that programs for the aged would be more equitable if the tax rate on unearned income such as Social Security and pensions were lowered and if asset limits were eliminated. An alternative treatment of assets would be to impute income to assets or to count a fraction of assets as income. Adopting these policies would imply abandoning the goal of restricting aid to the most needy and adopting equity in this sense as a goal. Both objectives are valid in designing an income transfer program. Whether the shift in goals occurs may well depend, as do so many features of the programs for the nonaged, on the political power of the recipients.

NOTES

[1]Initial eligibility is determined by comparing a family's net income to the full need standard, where net income is income less all of the permitted deductions except the first $30 of monthly earnings and one-third of the remainder. A family continues to be eligible if its benefit is positive, where the benefit is calculated using net income less all deductions and may be subject to the limitations described above.

[2]45 C.F.R. 233.20(a)(3). The Department of Health, Education, and Welfare first imposed a limit on assets in 1955, setting it at $1500 per recipient and increasing it to $2000 per recipient in 1966. Federal regulations which were scheduled to become effective in June 1975 would have imposed a limit of $2250 for a family of four, excluding the reasonable value of a home, an automobile with a retail value of $1200 or less, equipment needed for employment and some smaller items. Real and personal property were to be valued at their gross market value before deducting encumbrances. The courts invalidated this regulation, arguing that the gross market value of assets does not represent the amount of resources available to meet the needs of recipients when it takes no account of the debt on the property. See National Welfare Rights Organization v. Matthews (533 F. 2d 637, 1976).

[3]The regulations described in this section are contained in Department of Social Service (n.d.).

[4]This cannot be required of people who are expected to need assistance for less than three months.

[5]Exceptions to the limit on face value can be made (a) when the policy is a group and/or term policy; (b) when the policy is a family policy with the smallest face value available and a family member other than the primary

insured is uninsurable; and (c) when the policy is a family policy with the smallest face value available and the premiums on individual policies are greater than the family policy.

[6]This is not required of people who are expected to need assistance for less than three months.

[7]Data received from the Department of Health, Education, and Welfare.

[8]Exempt are children under age 16 or attending school full time, mothers or other relatives caring for a child under age 6, people who are ill, incapacitated, or 65 years of age or older, people who are so remote from a WIN project area that effective participation is precluded, people whose presence in the home is required because of illness or incapacity of another member of the household, and mothers or other female caretakers of a child when the father or other adult male relative has registered and not refused to participate in WIN. All individuals who are not exempt are presumed able to work and must register for the WIN program.

[9]When not otherwise indicated, information for this section was obtained from the Department of Health, Education, and Welfare, Social and Rehabilitation Service (1970). This publication describes the programs as they were in December 1969, and no later compilation of information has been made.

[10]These were the allotments in effect in 1976. The allotment is increased semi-annually if food prices rise.

[11]Neither the federal nor the New York State handbook of procedures provides criteria for determining what is "normal to the community."

[12]See U.S. Department of Agriculture, Food and Nutrition Service (1976). Only households not receiving AFDC or SSI were included in the study.

[13]Exempt are children under 18 years and the elderly age 65 and over, people who are not able-bodied, including alcoholics or narcotic addicts in a treatment program, mothers or other household members who care for children under age 18 or incapacitated adults, students enrolled in school at least half-time who are not tax dependents of noneligible households, and persons working at least 30 hours per week. The work requirement is specified in 7 C.F.R. 271.3(d).

[14]This is indicated by data from the Employment Service Automated Reporting System.

[15]Data received from the Food Stamp Unit, Office of Work Incentive Programs, Employment and Training Administration, Department of Labor.

[16]Provisions apply equally to widowers.

[17]Letter received from the Director of the Compensation and Pension Service, Veterans Administration, dated April 1, 1977.

[18]Workers are fully insured if they have one quarter of coverage for each year after age 21 and before age 62, or one quarter of coverage for each year after 1950 and before age 62. They are currently insured if they have 6 quarters of coverage during the 13 quarter period ending with the quarter in which death occurs.

[19]The Primary Insurance Amount is increased automatically with the Consumer Price Index. Few, if any, families are eligible for the highest benefits, since their average monthly earnings were earned when the wage base was lower than it is now.

[20]The limits on exempt earnings are increased automatically with the average covered wage.

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Rules and Practices for the Taxation of Income and Assets in Income-like Subsidies for Housing, Medical Care, and Higher Education

Leonard J. Hausman

To be evaluated properly, the rules in an income transfer program regarding the treatment of assets and income from assets must be viewed as but one subset of rules determining a beneficiary's net taxable resources and, in turn, net subsidy.[1] These include program rules that affect work effort and earned income, the size of the filing unit, the definition of taxable resources, the income accounting system, and administrative practices regarding enforcement of these several subsets of rules.[2]

In detailing and assessing the rules on the taxation of assets in commodity subsidy programs in the fields of housing, medical care, and higher education, an important concern is whether in general, the particular commodity subsidy seeks to cast its net widely or narrowly. A "widely cast net" in an income or income-like commodity subsidy program maximizes the fraction that taxable resources are of total resources. This maximization can involve pressuring a unit to sustain stocks and flows of resources at a high level; defining the filing unit broadly to include all those to whom resources may accrue; making the definition of taxable resources comprehensive, allowing only those exclusions or deductions that create a refined, net definition of taxable resources; drawing out income acounting periods over a long time, like twelve months, and making them retrospective if reconciliation mechanisms are unacceptable; setting tax rates at levels that result in substantial contributions to purchases of the commodity; including in taxable resources a sizable fraction of assets; and rigorously enforcing the rules written to implement the above specifications.[3]

Against this backdrop, one can assess the rules for determining taxable income and taxable assets in, for example, a housing subsidy program. Suppose that once a filing unit qualifies for benefits the program exerts no pressure through a work test of one form or another to maintain labor income. Suppose further that rules allow for exclusion from the filing unit of persons not in the nuclear family or even young people in that family, thereby excluding the income of such persons from taxable resources. Also, imagine that this hypothetical program excludes or deducts from taxable resources generous amounts of regular income flows. Its income accounting system contains a long prospective accounting period without a reconciliation mechanism. Tax rates on taxable resources are very low. Accounting practices are casual and inexact. Set in this web of rules and practices, which combine to minimize taxable resources per grouping of persons, are those for assets. In this housing subsidy program, would it not be anomalous for asset rules to be stringent? That is, unless a specific program objective were being served, anything but liberal exclusions of assets and/or administrative indifference to their existence would appear to be entirely inconsistent with the other elements of the subsidy program.[4]

What follows, therefore, is a characterization of housing, medical care, and higher education subsidy programs that indicates how widely they cast their respective nets and concentrates on detailing their rules for assets. The second section discusses enforcement practices regarding assets in the three program areas. A concluding section considers possible revisions in current rules and practices.

1. RULES RELATING TO TAXATION OF INCOME AND ASSETS

Housing Programs

Subsidy programs in housing include Low Rent Public Housing, Section 101 Rent Supplements, Section 8 Housing Assistance, Section 236 Rental Assistance, and Section 235 Homeownership Assistance. These income-like subsidy programs make scant effort in their rules and administration to maximize a filing unit's taxable resources as a fraction of available resources. This inference can be drawn from the review that follows of their work tests, filing unit and income definitions, income accounting procedures, tax rates, lien laws, and asset tests.[5] Given available resources, benefits per recipient are not minimized.

Often called "work tests," work registration requirements in income support programs are typically procedures to monitor recipient availability and search for work. Such formal, explicit procedures do not appear in any of the housing subsidies, where more subtle, and perhaps more stringent work tests may operate. Tenants in housing developments eligible for the various rental subsidies are selected by the managers of the developments. If tenants are screened on the basis of their stability and reliability, initial eligibility for the housing subsidy may be effectively conditional upon actual work effort. Having established eligibility, however, tenants are not subject to formal monitoring of their labor market behavior. Thus, no pressure is placed upon them to maintain their labor incomes at a particular level.

The filing or recipient unit is defined narrowly in each of the five housing subsidy programs. The formal unit, both for setting the unit's

guarantee and for determining whose income is to be combined for purposes of taxation, invariably is the family, not the household.

In some income support programs, provisions exist regarding relative responsibility and "deeming." The former are requirements that a portion of the income of specified relatives be contributed to the filing unit and effectively included in its taxable resources.[6] The latter are program rules on legally required filing units that allow an agency to assume that a group of persons is pooling income, without regard to whether such persons actually are pooling income or are related. Housing programs contain no provisions on relative responsibility or deeming. When eligible units live with persons beyond the nuclear family with whom they do pool income, the absence of such provisions results in taxable resources being smaller than those actually available.

The definition of income or resources in the five housing subsidies are rather comprehensive, but typically contain substantial exemptions and deductions. Items subtracted from gross income go beyond those relating to costs of generating income. The obvious result is a considerable narrowing of taxable resources.[7] Typically included in income for the purpose of determining net subsidies are all forms of labor income and property income, as well as public and private cash transfers. In the Homeownership Assistance program, there is a specific exclusion for nonrecurring unemployment insurance benefits. Excluded in all five programs is the income of persons under 18 or 21. In the Low Rent Public Housing program, the exclusion of the labor income of young people holds only for persons under 18 and enrolled in school. In the Homeownership program, the exclusion holds for all persons under 18 and other persons enrolled full time in school. A standard deduction of 5% of gross income from all

sources applies in all five of the housing programs, as well as an exemption of $300 for each minor child. Also found in the Low Rent Public Housing and Rental Assistance programs is a deduction of $300 from the annual earnings of the spouse of a head of a household. Child-care expenses and unusual medical expenses also are deductible in some instances.

The two latter deductions are appropriate if the objective is to have net or available income as the tax base. Since guarantees vary with family size insofar as large apartments are allocated to larger families, the $300 exemption per minor child and the standard 5% deduction from gross income, by contrast, appear designed solely to constrict the tax base. The obvious intention of this constriction is to raise net benefits per beneficiary, not to yield an appropriately refined measure of net income.

Income accounting periods are annual and prospective in all five housing programs. In Public Housing and in Housing Assistance, the periods are explicitly prospective. In the other three programs, benefits for the current year are based on income in the previous year. The implicit assumption here is that income in any two adjacent years will be virtually equal. Given generally rising incomes, however, annual accounting periods of the latter variety yield, on average, higher program costs than would systems attempting an adjustment of benefits to a more current measure of income. Again, assuming generally rising incomes and barring accurate reporting of changes in income as they materialize during a year for which a forecast has been made, both types of prospective systems without a reconciliation procedure will result in higher program costs than would some alternative systems.

A last indication of the disinterest of housing programs in minimizing subsidies per beneficiary, given guarantees and actually available funding, is the level of the tax rate on taxable resources. Across programs the nominal tax rate on the components of cash income is typically 25%.[8] These tax rates may be viewed as low if the intent in setting them was to keep a family's rent costs to 25% of income. Income, after all, could be considered to be income inclusive of the housing subsidy. A tax rate of 25% of income, exclusive of the subsidy, results, obviously, in a much lower rent/total income ratio where the housing benefit is large (which, typically, it is).

Prior to describing rules for the treatment of assets in housing, as well as medical and education programs, various aspects of such rules should be delineated. One aspect is that they may relate to either initial or continuing eligibility, or both. A second is the comprehensiveness of the definition of taxable assets: whether the definition includes all nonhuman capital, as well as human capital, and contingent rights to pensions.[9] A third is whether income is imputed from nonearning taxable assets. A fourth is whether an imputation is made for capital consumption of taxable assets.

Assets rules in housing subsidy programs relate both to initial and continuing eligibility. As an initial screening device, limits on assets are established federally in the Rent Supplement, Homeownership, and Rental Assistance programs. In the Public Housing program, the limits are set by local housing authorities. In Boston, for a family of four in 1976, the assets limit in the latter program was 150% of the limit on income of $12,350, or well over $18,000. In the Rent Supplement Program,

the limit on assets for the nonelderly is equal to the limit on income in the Public Housing program; for the elderly, the limit on assets is equal to three times the limit on income. In the Homeownership program, the limits are $2,000 for the nonelderly and range from $25,000 to $50,000 for the elderly. In the Rental Assistance program, the limits again are $2,000 for the nonelderly but only $5,000 for the elderly and handicapped. No initial limits on assets obtain in the Housing Assistance program.

Definitions of taxable assets for purposes of initial or continuing eligibility vary substantially among the five programs. In the Public Housing program, the definitions are set by, and thus vary among, local housing authorities. Identical definitions hold for the Homeownership and Rental Assistance programs. Taxable assets, i.e., those that could affect eligibility, include the values of business property, farm or ranch, other real property, tangible personal property, stocks, bonds, time deposits, and demand deposits. Added to these in the Rent Supplement program are the value of a car and the cash value of life insurance. The Housing Assistance program deletes the filing unit's car and furniture, but adds the present value of private pension rights--apparently excluding OAI rights. The latter, therefore, is an exceedingly comprehensive definition of taxable assets.

Only in the Housing Assistance program is there the possibility of an imputation of income from nonearning assets and an imputation for capital consumption. In this program, for filing units with taxable assets exceeding $5,000 in value, there is a tax on assets equal to the difference between 10% of their value and income from such assets. Since returns on capital are not likely to average as much as 10%, this approach is likely to involve some combination of an imputation of returns to nonearning capital and forced capital utilization of income-producing capital.

Can the sets of rules in the five housing programs regarding the treatment of assets be labeled liberal or stringent? The answers vary among the programs and depend upon the distribution of assets in the population. If most persons in the low and moderate income population have assets falling below levels like $12,000 and $18,000--and this seems to be the case[10]--then the Public Housing program in places like Boston is quite liberal. This is especially true because lump-sum additions to assets, such as inheritances, insurance payments (like Workmen's Compensation), and capital gains are excluded from taxable income in setting net benefits, although they would count in seeing whether assets remain below legal limits. The Rent Supplement program has the same limits on assets for the nonelderly and more liberal limits for the elderly than does Public Housing. The Homeownership Rental Assistance programs are rather stringent with the nonelderly. The Housing Assistance program, which probably will become the major subsidy program in housing, compels, on the average, minimal capital utilization. The rule spelled out above seems only to reduce the growth rate of assets; it does not result in appreciable capital utilization. If liberal enforcement practices regarding assets also prevail in housing, the treatment of assets can be considered generally liberal.

Medical Programs

Programs subsidizing medical care make very limited demands on the resources of filing units. Once persons qualify for participation in the major medical care subsidy programs, benefits can be large and unaffected by income or other resources. The two major income-conditioned programs for the support of medical care purchases are Medicaid and Health Assistance

for Veterans with Non-Service Connected Disabilities. Medicare, basically intended for beneficiaries of Old Age and Disability Insurance, is the other major program subsidizing health care consumption; however, since participation in Medicare is not conditioned by income, it is not considered further here.

Neither Medicaid nor Health Assistance for Veterans contains a work test. In fact, since the "categorically needy," i.e., those eligible for Medicaid because they receive AFDC or SSI, qualify for comprehensive Medicaid benefits as long as they remain in these programs, persons in this group in effect are encouraged to keep their incomes low, not high. Similarly, in the veterans' program, since persons with incomes above specified limits theoretically are ineligible for benefits, veterans are induced to maintain (or at least report) low incomes.

The filing unit in Medicaid either is coincident with the unit receiving AFDC or SSI, or is the family. In the veterans' health program, benefits are available only to the veteran, not to members of his family. In determining eligibility for prescription services and domiciliary and restoration care, however, family income is supposed to be considered. Only the veteran's incomes are considered in determining eligibility for hospitalization, presumably to make such medical services more broadly available to them.

Relative responsibility and deeming provisions do not obtain in the veterans' program, and in Medicaid, interestingly, are less demanding than those in AFDC or SSI. Spouses are held responsible for each other. Parents are held responsible for children who are under 21 or who, whatever their age, are permanently and totally disabled. In contrast to AFDC, state laws

or regulations on Medicaid cannot require other family members to be responsible for each other.

As noted, in Health Assistance for Veterans, the definition of income varies with the medical care service demanded. To gain admittance to a hospital, a veteran only must swear to his personal inability to defray hospital expenses. To obtain domiciliary care, family income is the relevant measure and is defined comprehensively. To obtain prescription services, again family income is assessed, and is defined much more narrowly. Distinct definitions of income under Medicaid for recipients of AFDC and SSI are not needed by virtue of the automatic eligibility of such persons for Medicaid. The "medically needy," i.e., those who qualify for Medicaid because their net incomes fall below 133.33% of their respective AFDC and SSI standards, have the same definition of net income as do filing units receiving AFDC and SSI in their respective states. Clearly, the Health Assistance for Veterans program in determining eligibility for hospital services defines narrowly both the filing unit and taxable income--allowing the latter to be anything the veterans choose to make available to cover expenses of such care--to make such services rather equally available across a broad range of actually available resources.

In both the Medicaid and veterans' program, the income accounting period is prospective, six months in Medicaid and varying with the service desired in the veterans' program. No reconciliation mechanism is utilized. The programs, therefore, while responsive to need, do not adjust benefits to actually available resources. Again, with generally rising incomes, this provision fails to minimize benefits given available resources.

One way to vary benefits gradually with income is to have a positive tax rate on income at all levels. The design of both Medicaid and the veterans' program yields severe notch problems, i.e., tax rates far exceeding 100% at the breakeven level of income or resources. For the categorically needy receiving Medicaid, eligibility for exhaustive medical care services under Medicaid is lost when eligibility for AFDC benefits is terminated. Eligibility for Medicaid is not regained for such filing units until medical expenses reduce net taxable resources to 133.33% of the state AFDC cost standard. For a filing unit whose medical expenses equal or exceed the difference between its breakeven level and 133.33% of the cost standard, the tax rate on income is only 100%; no "notch" exists for them. Similarly, the veterans' health program, by establishing an all or nothing eligibility rule related to a particular level of income, has created a notch problem. Graduating benefits with income in Medicare and in the veterans' health program by having tax rates between zero and one would reduce subsidies per beneficiary. Currently, except by having different income rules for different medical services in the veterans' program, subsidies per beneficiary under both programs can be large and vary only with amounts of service demanded.

Assets tests obtain in both the Medicaid and veterans' health program. In Medicaid, the assets tests for the categorically needy are those in the various state AFDC and SSI programs and vary widely among states. Generally, however, they apply as a condition of initial eligibility; often exclude certain assets, like cars and homes; put tight limits on the amount of non-excluded assets that may be held; and then simply make ineligible those filing units whose assets exceed the limits, rather than compel capital utilization at a rate of less than 100% above such limits.[11] For the medically needy, assets tests are generally slightly more liberal than are those in

the AFDC and SSI programs of the respective states, insofar as the limits or nonexcluded assets are higher. Otherwise, the rules are comparable. In the veterans' program, by contrast, a stringent assets test is involved whe a veteran must take a poverty oath to obtain hospitalization services. Apparently, though, the Veterans' Administration has great discretion in deciding whether to compel the exhaustion of an applicant's assets.

Higher Education Programs

Two income support programs in higher education are considered here: the Basic Educational Opportunity Grant program (BEOG) and support from individual institutions guided by the Parent's Confidential Statement of the College Scholarship Service (PCS-CSS).[12] The former is a government program. Although the latter is not, it is considered in this paper because of the interestingly detailed manner in which it taxes assets. The BEOG and PCS-CSS programs are conventional financial aid mechanisms. Both provide financial aid in the form of support for tuition and living expenses, the amounts varying inversely with the taxable resources of the filing unit.

The BEOG and the PCS-CSS programs have no explicit work tests. The PCS-CSS, however, provides guidelines to schools as to the amount of a student's expected savings from summer earnings that must be included in taxable resources. The addition of such expected savings to the actual tax on family resources is a work test. Financial aid officers are encouraged to consider differences in student circumstances, e.g., employment prospects, when setting a level of expected summer earnings, but

this provision does offer them an opportunity to exert pressure on students to work. To the extent that this provision is used, it becomes the most stringent work test in any of the commodity subsidy programs being considered in this paper and is quite analagous to rules on expected seasonal earnings and deeming in welfare programs of yesteryear.

The filing unit rules in the BEOG and the PCS-CSS programs are identical. These rules clearly are critical to equitable operation of the program. A student is required to consider himself/herself part of any family or household in which a person has claimed him/her as an exemption for federal income tax purposes, either in the year in which the student will receive aid or in the preceding year; or part of any household or family from which the student received $600 of financial support in either of those two years. If the student has lived with his/her immediate family in either of those two years, he/she cannot claim to be independent, even if he/she has not received support from it or has not been claimed as an exemption for tax purposes by a member of it. Applicants for aid using either the BEOG and PCS-CSS forms must sign a waiver allowing schools to which they apply to obtain a copy of their parents' income tax form to establish dependency status (and verify income information).[13] Though the first condition listed above can be enforced, the second and third are far more difficult to administer. This is considered in Section 2. Obviously, to the extent that the two programs allow evasion of the filing unit rules, they will be disbursing benefits to some students far greater than those justified by actually available resources.

The definitions of the net income component of taxable resources in the BEOG and PCS-CSS programs are similar, quite specific, rather comprehensive, but perhaps overly refined. Stated compactly, dependent students, members of a filing unit including their parents, must sum their parent's

adjusted gross income (AGI) and nontaxable income, where the latter includes public and private cash transfers, with their own income. Missing from taxable income in both programs is the imputed income from housing accruing to those living in their own homes. Deductible from income are large medical expenses and federal income taxes, as well as an employment expense allowance, in two-parent families where both parents are employed and in one-parent families where the parent works. Generally speaking, more liberal deductions are allowed under the PCS-CSS program than under BEOG. Most notable in this regard are the minimum standard deductions in the two programs. For a four-person unit the standard deduction from income was $7350 (in 1976) in the PCS-CSS program and $5600 (in 1975) in the BEOG program. This difference is too large to be explained entirely by the adjustment in the deduction that was made for inflation between 1975 and 1976 in the PCS-CSS program.[14] Moreover, the PCS-CSS program allows deductions for such items as funeral expenses, legal fees, private schooling for children below the college level, sewer and street assessments, and termite control. Some of these items are not expenses generated in earning income or necessary to maintaining a minimum standard of living. The existence of these deductions suggest the desire on the part of the CSS to weaken the relationship between grant support from schools and family income.

The BEOG and PCS-CSS programs contain the most elaborate treatment of assets that one can find in commodity subsidy programs. Yet, as the ensuing detailed consideration of the rules reveals, these elaborate treatments result, nevertheless, in very low taxation of assets. The basic intent of the two programs appears to be the development of a technique that allows filing units to keep their assets intact in a horizontally equitable manner. While the growth of assets should not occur when aid is received,

neither should significant depletion of assets. Assets are to be retained for other functions, like protection against the financial consequences of retirement.

The PCS-CSS program determines for each filing unit a measure of "discretionary net worth" (DNW). A small fraction of this is added to taxable income. This sum, net taxable resources, is taxed at progressive rates.

The PCS-CSS process of taxing assets begins by defining them rather comprehensively. Included in taxable assets are residence equity, other real estate equity, stocks and bonds, cash assets, and adjusted business or farm net worth. In contrast to the Housing Assistance program, the cash value of life insurance is excluded. As in most welfare programs, the value of consumer durables also is excluded. Against assets, a host of debts not related to consumer durables are deductible. Such debts include past due alimony, child support, legal fees, and medical expenses.[15]

Before a fraction of net worth can be added to net taxable income, families are allowed to claim an "asset protection allowance." This asset set-aside is supposed to allow for an amount of income that is needed to commercially purchase an annuity for retirement. The annuity should be equal to the current difference between a moderate income level, as defined by the BLS, and that afforded by OAI benefits. The cost of such an annuity policy would vary with the age of the primary working parent. Therefore, the asset set-aside is adjusted for this factor. In a family with two parents, where the primary worker was 50 in 1976, the asset allowance was $12,510 in that year. The allowance was larger in one-parent units as well as in those with farm or business net worth.

Discretionary net worth is arrived at by deducting the asset allowance from net worth. Only 12% of DNW then is added to net taxable income.[16] To arrive at total net taxable resources, 33% of the assets of a dependent student are added to 12% of DNW plus net family income.

Including 12% of DNW in net taxable resources obviously does not mean that assets are taxed at a 12% rate. Applied to net taxable resources in the PCS-CCS program is a schedule of progressive tax rates. This schedule applies to net taxable resources or "adjusted available income," as the PCS-CSS uses the term, after a standard deduction varying with family size is made from income. This deduction from income, not to be confused with the asset set-aside, was $7,350 for a family of four in 1976. As can be seen from the schedule below, average tax rates are negative to begin with; then marginal rates advance rapidly from 22% to 47%.

Net Taxable Resources or Adjusted Available Income (AAI)	Total Parents' Contribution
$-3,410 or less	$-750
-3,409 to 4,280	22%
4,281 to 5,350	$941 plus 25% of AAI over $4,280
5,351 to 6,420	1,208 plus 29% of AAI over 5,350
6,421 to 7,490	1,518 plus 34% of AAI over 6,420
7,491 to 8,560	1,882 plus 40% of AAI over 7,490
8,561 or more	2,310 plus 47% of AAI over 8,560

Thus, a tax rate always less than 50% applies to 12% of DNW. Discretionary net worth is never taxed, therefore, at a rate of more than 6%. In short given an average growth of capital of 5%, the PCS-CSS program results in minimal or negligible capital utilization. Since income is not imputed to nonearning assets, on the average there is no capital utilization. This treatment of assets seems consistent with the general liberal treatment of income and assets in commodity subsidy programs.

The treatment of assets is almost as elaborate in the BEOG program as in the PCS-CSS. Assets are defined as in PCS-CSS, seeming also to exclude the cash value of life insurance. Debts against included assets are deductible. From net worth is deducted a uniform "asset reserve," $12,500 in 1975 for families without business or farm net worth or $25,000 for those with such net worth. Added to net taxable income in this program is 5% of its definition of DNW. As the BEOG manual states, "...this rate of assessment will generally leave the family's assets position largely unimpaired. A 5% rate is equal to or below current real estate and savings account appreciation rates, and therefore seems reasonable."

As with the 12% assessment rate of DNW in PCS-CSS, the 5% rate is not a final effective tax in the BEOG program. Above a standard deduction of $5,600 for a family of four in 1975, a constant tax rate of 20% applies to the sum of net taxable income, 5% of DNW, and 33% of the student's assets.

The tax structure in the BEOG program as in the PCS-CSS program reflects an intent to be quite generous towards moderate income filing units. Over an exceedingly large range of income, tax rates are zero because of the minimum standard allowances. They begin at modest levels in both programs, but rise rather rapidly in the PCS-CSS system. The only sense in which they are high is that when combined with federal and state income taxes and OASHDI taxes, they bring families at modest levels of income to total tax rates of more than 40%. Of course, such rates only apply for the period during which a family's children attend college. That number of years, however, can be large in families with several, spaced children. The

BEOG and PCS-CSS programs are not strictly antipoverty aid programs: Their target populations are considerably larger than the poor population.

Lastly, it is obvious in the descriptive material above that the income accounting period in the BEOG and PCS-CSS accounting systems is annual and prospective. Income for the current year is assumed to be equal to income for last year. Where income is expected to fall substantially between the last tax year and the current year, students are allowed to file information asking for an upward adjustment in aid.

2. ENFORCEMENT PRACTICES

Practices regarding the treatment of assets and income from assets can be evaluated accurately, of course, only after a substantial effort to gather information. Such an effort was impossible in the preparation of this paper. Conveyed here is impressionistic information based on a very small number of casual, personal interviews. Generally, the story on practices in the housing and medical programs is consistent with rules that reflect the narrowly cast income and assets net mentioned earlier: Given the rules, a very limited and unsystematic effort is made to determine the existence and value of assets. This is not the case in the two higher education programs.

Housing Programs

Noted previously, four of the housing programs use assets tests as a screening device in the eligibility process. For most filing units these limits are likely to be inconsequential. For the few filing units whose assets exceed such limits and who seek to qualify for benefits under these programs, such rules on assets necessitate either evasion or capital utilization at a 100% rate above the specified limits. Only in the Housing

Assistance program is there an assets rule unlikely to induce evasion or capital utilization at a very high rate on the part of any filing units.

How carefully are assets checked in the process of determining eligibility? An official in the Loan Management Branch of a Boston area office of the Department of Housing and Urban Development (HUD) pointed out that the responsibility for obtaining and verifying the information on assets on application forms lies with those managing housing developments in which some tenants are eligible for one of the various subsidies. After the management of a project processes the applications, they are forwarded for review to the HUD area office.

It is hard to imagine how the management of a housing project could do more than check for internal consistency the materials on income and assets provided by applicants. Monitoring and verifying income is a complex process, which is enormously costly per applicant when done on a small scale basis. Moreover, in the absence of any penalties for casual and lax enforcement, one wonders why such management of a project should take seriously the reporting and verification of income and assets. Does such a management have any interest in equity issues or antipoverty objectives?

In actuality, there are no penalities for casual enforcement of eligibility rules on income and assets. The particular HUD area office from which the information for this section came has respc ility for 365 apartment developments containing 16,000 housing units. It has five people working regularly on the review of applications and recertification forms, giving each worker an average of about 65 cases per week to process. The HUD official's view was that this was an overwhelming workload. Given the technology available to such housing officials, it certainly must be. The response of the office to the workload is to not check assets at all where

housing developments are in low income districts. In projects not in low income neighborhoods, the office focuses on elderly applicants. Largely, then, enforcement of assets rules as screening devices is done on a very decentralized and probably haphazard basis. The HUD area office could provide no information on evasion or avoidance of assets rules.

In addition to discussing the enforcement of rules on assets, it is worth noting that project managers felt that increases in income are reported annually, not during the year where that is required. Not surprisingly, decreases in income are reported during the year as they occur.

Medical Programs

In checking on administrative practices in the Medicaid program, officials at three different offices in the Boston area were interviewed. Enforcement practices varied widely among the offices.

Employees at one office reported that information on assets in applications from persons seeking to qualify as medically needy was almost never verified. One official noted that in his view, some applicants transfer property to other persons to qualify for benefits; and some own "secondary" land of which they make no mention when applying. This office took seriously, however, verification of information on income. Nevertheless, a rough estimate was that 10 percent of those leaving the Medicaid program in this area were disqualified because they exceeded the legal limits on assets.

Employees at another office did attempt to enforce rules on assets. After receiving permission from applicants or clients, the Medicaid office did attempt to verify savings accounts, stocks, and secondary real estate holdings. Inconsistencies between information on income from assets and

the reported value of assets were followed up. Nevertheless, there was a general sense of the difficulties involved in the verification process: Clients were felt to give minimal and inaccurate information; transfers of assets were made; limits on department resources precluded exhaustive inquiries. In the view of the few officials contacted for information, evasion and avoidance are especially widespread among older persons.

The Medicaid program, it is commonly known, faces enormous problems in monitoring the bills of those supplying medical services to beneficiaries. Devoting scarce resources to verification of information on assets in fact may be irrational in this context.

Enforcement of rules on the taxation of income and assets in the veterans' health program is minimal. Assets generally are not taxed at all, certainly not by going into the estates of veterans. Even the variation in rules for the taxation of income by the type of service demanded seems to be non-existent in practice.

Higher Education Programs

In a paper written in 1973, Hansen and Lampman predicted the BEOG program would encounter a major problem in trying to relate student financial aid inversely to the income of a student's actual family. They expected a serious filing unit problem to develop because college students generally tend to move in and out of their immediate families and because the incentives in this program to report that they are out of their families are substantial. According to the impressionistic information made available to me at this time, a serious filing unit problem has developed both in the BEOG and the PCS-CSS program.

The financial incentives for a student to separate for filing purposes from his family can be sketched briefly. In the PCS-CSS program, if a student establishes his independence, his family's income—above the standard deduction—is free of taxation at marginal rates varying between 22 and 47%; and their assets—again, above the asset set-aside—are free of taxation at rates varying between roughly 2.5 and 6%. For most students, moreover, being independent will result in a lower tax rate applied to their (lower) personal income. Summer earnings, as noted above, are highly taxed when a student is a dependent of his family. By contrast, all earnings under $3,180 per year are untaxed if a student has established that he is self-supporting. (It should be noted, though, that earnings not accruing in the summer to a dependent student appear to be excluded from taxable resources unless they are included in family AGI.) Assets of a student are taxed at the same rate regardless of his dependency status.

In the BEOG program, most students will face the same tax on personal earnings whether or not they are associated with their immediate family. If dependent, a student's earnings appear to be excluded from taxable resources unless included in family AGI. If independent, earnings of a single student are taxed only to the extent that they rise above $1,000 per year. The big gain from establishing independence accrues in this program as in the PCS-CSS program to a student's family, where its income and assets exceed the respective deductible amounts. A student with low earnings from a family with net taxable income of $5,600 and a net worth of the same amount, currently could save his family $1,400 annually if he established independence.

3. CONCLUSION

Two findings emerge from this paper. One is that in existing needs-tested commodity subsidy programs in housing, medical care, and higher education a spirit of fine tuning benefits for differences among filing units in available resources is by and large absent. Designers of these programs seemed intent on distinguishing between eligible and ineligible populations. Within the pool of eligibles, which typically extends beyond the poor to those with modest incomes, there is little apparent interest in adjusting net benefits so that they vary inversely--and sharply--with available resources. The intent of the designers is apparent from the absence of work tests, narrow definitions of filing units, potentially sizable exclusions and deductions from gross income, long and prospective accounting periods, and low nominal tax rates on taxable income. Joined with these program parameters are either of two types of rules on assets: The first type excludes from taxable assets significant categories of asset holdings and imposes as a condition of eligibility rather liberal ceilings on taxable assets; the second type essentially taxes assumed appreciation in the value of assets, thereby avoiding double taxation but attaining a tax on a form of property income.

A second finding is that where ceilings on assets are not high, lax enforcement of asset rules spares potential beneficiaries from rapid consumption of their capital. People with assets that make them ineligible can easily avoid reporting them or transferring them nominally to friends and relatives.

What are the implications of these two findings for changes in the rules and practices regarding assets in these programs, especially as

the programs affect the aged? In these commodity subsidy programs, low weights have been attached to two objectives: that of reducing poverty at least cost, given financial resources actually available to persons sharing residences and pooling resources; and that of disbursing benefits in a horizontally equitable manner. Greater weight has been attached to encouraging consumption of the particular commodities across a broad span of filing units by reducing prices and/or raising incomes rather evenly among low and moderate income groups. If this is an accurate view of these programs, one must ask why only the rules on assets should be altered in the interest of (one definition of) horizontal equity. By making the rules on assets more stringent, either a redistribution of benefits from the aged to the nonaged within the programs will be affected, since it is the former who by and large have assets; or, if the aged who have assets continue to be treated more generously than the nonaged who have assets, a redistribution from all those with assets to those without will be accomplished. Without pursuing Taussig's (see paper in this volume) question of whether horizontal equity is attained when assets are taxed, the latter outcome is difficult to accept when only a small interest exists in channeling benefits away from those with income to those without it.

Another implication of the findings is that if, in general, greater weight should be attached in the subsidy programs to the objectives of reducing poverty at least cost and in a horizontally equitable manner, the practical problems and thus costs of valuing and verifying assets suggest the need for a "one-window" approach to their administration.[17] In the two higher education programs, BEOG and PCS-CSS, the high costs of administration have been acknowledged: Central administration of income and asset reporting

has developed. Even large programs like Medicaid cannot afford to monitor income and assets by itself. For the categorically needy, income and assets are now verified at one window, the AFDC window. Medicaid administrators choose--wisely, no doubt--to spend resources available for policing activities on problems more significant, costly, and unique to that program.

A last implication is that, given a one-window system which also seeks broadly to attain horizontal equity, a reasonable approach to the taxation of assets is that embodied in the higher education programs, taxation of the appreciation in the value of asset holdings.

NOTES

[1]Taxable resources are the sum of income and that fraction of assets to which the tax rate(s) in a program are applied.

[2]In commodity subsidies requiring the purchase of a voucher, the tax rate on resources is labeled a contribution rate. Whether or not the purchase of a voucher is required, this rate is obviously a determinant of the beneficiary's net benefit.

[3]In his paper in this volume, Robert Lerman argues that since transfer programs serve conflicting objectives, some program parameters can be adjusted to meet certain objectives while other parameters are designed to meet other ends. For example, a program seeking horizontal equity generally may cast its net widely; but the filing unit rules may exclude, at the expense of a widely cast net and thus perfect horizontal equity, the income of children in school to promote their enrollment. (Thus, it is of some—but not exclusive--interest to investigate the question raised in this paragraph when assessing rules on assets in the context of an entire program.)

[4]Michael Taussig notes in his paper in this volume that complete exclusion of assets from taxable resources is consistent with an interpretation of horizontal equity that involves equalizing tax burdens for equal lifetime incomes (assumed equal to lifetime consumption). Liberal exclusions of assets thus also could be considered consistent with an attempt to otherwise maximize the fraction of available resources defined as taxable.

[5]Two principal sources were used for information on the rules detailed for the housing and medical programs; see U.S. Congress (1974), and Abt Associates (1977). Supplementary information was obtained from a variety of documents and application forms from local offices of the Department of Housing and Urban Development.

[6]Relative responsibility rules may require that the filing unit merely seek the support of specified relatives before establishing eligibility for benefits. Upon receipt of such support, AFDC then excludes it from the unit's income, but uses such funds to offset general program costs. (See Bayne 1976.)

[7]Income sometimes is defined differently within a particular program for purposes of initial and continuing eligibility. For the former purpose, local regulations may be binding. For the latter purpose, which includes the determination of the eligible unit's net benefit, uniform federal regulations typically prevail.

[8]Exceptions arise; for example in the Section 8 Housing Assistance Program, where the tax rate is lowered for larger families as well as for those with large medical expenses to as low as 15%. Why this is done when the guarantee (in the form of apartment size) is adjusted for family size is unclear.

[9]A comprehensive definition of assets is defined and considered by Taussig in his paper in this volume.

[10]A recent study of families whose children applied for financial aid through the College Scholarship Service (CSS), notes that 70% of such families had net worths of $20,000 or less. Housing programs, of course, test for assets. But families in the CSS study undoubtedly overrepresent--as compared with the general population--families in the middle income classes.

[11]Rules on the treatment of assets in the AFDC and SSI programs are discussed in the papers by Irene Lurie and Marilyn Moon, respectively, in this volume.

[12]The information on which this section is based is drawn from Department of Health, Education, and Welfare (1975), and College Scholarship Service of the College Entrance Examination Board (1976, pp. 9-30).

[13]Brandeis University, to cite one isolated example, obtains the 1040 forms in every case in which an award is made.

[14]Such an adjustment is also made in the BEOG program.

[15]In an excellent, highly detailed analysis of the treatment of assets in the PCS-CSS system, Bawden and Crumpton-Bawden (1977, pp. 16-18) note that some of these "past due" debts also become deductible from income when paid and discuss this double counting.

[16]The rules for the conversion of discretionary net worth to taxable resources in the PCS-CSS program are somewhat more complex than is indicated by this statement. They might be stated in the following way:

when DNW is	and	net taxable or available income is	DNW is assessed at
$0 or greater		any amount	12%
Less than $0		$4,280 or greater	0
Less than $0		$4,279 or less	6%

The effect of the rule in the third line is to lower taxable resources for persons with negative DNW by having 6 percent of it subtracted from taxable income.

[17]Under a one-window system, beneficiaries submit information on their relevant characteristics to a single worker at a single office. This office then becomes responsible for using such information to determine net benefits for particular people under two or more programs.

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Treatment of Assets and Property Income in Designs for Negative Income Taxation

Robert I. Lerman

Serious analysis of the negative income tax (NIT) is now in its second decade. The first decade of research and analysis generated a considerable amount of knowledge about the likely economic incentive effects of NIT and about several important technical and administrative issues. Although the primary emphasis has been on how NIT would influence the amount recipients work, much attention has also been devoted to the issue of how to relate benefits to the amount of assets and nonemployment income.

Still another paper on this subject can serve two purposes. One is to review some of the principles that have been proposed concerning the treatment of assets and nonemployment income. The second is to assess actual choices of program rules by highlighting some important tradeoffs. The paper proceeds with these tasks in the following order. Section 1 states the primary objectives of NIT designers in determining program rules. Section 2 lists the program features that relate to the treatment of assets and nonemployment income and how they interact. In section 3, the rules for the relevant program features in four NIT legislative proposals are described. Section 4 discusses how and why these rules deviate from the personal income tax treatment of assets and nonemployment income. In section 5, the relative effectiveness of two sets of NIT rules in achieving the major objectives is compared. Section 6 reassesses some important tradeoffs and takes on the conventional wisdom with regard to the desirability of imputing income to a comprehensive definition of assets. Section 7 reviews the primary conclusions of the paper.

1. OBJECTIVES IN THE TREATMENT OF ASSETS AND NONEMPLOYMENT INCOME:

The objectives guiding designers of negative income tax (NIT) proposals have become a blend of tax policy and welfare policy considerations. Milton Friedman's original idea called for a simple extension of the personal income tax to those below the tax threshold. He envisaged a payment equal to some tax rate (like 50%) times the gap between the unit's income and tax threshold. It was soon realized that this kind of proposal--while true to tax principles--could not resolve the problems in the welfare system and certainly could not constitute welfare reform. Basing payments on a fraction of the exemptions implied an income guarantee level far below existing welfare standards. To do anything that would seriously reduce poverty required raising the NIT income guarantee. Once the notion of making NIT the tool for assuring an adequate income for all American families took hold, NIT advocates had to compromise on their goal of reshaping welfare into a pure tax system and to begin turning to welfare policy considerations. At minimum, what was required was a high benefit reduction rate, a redefinition of the filing unit, a change in the tax system's simple annual accounting period, and a widening of the concept of income.[1]

These moves away from strict tax ideas and toward welfare concepts have been most pronounced in the case of assets and unearned income. Nearly all earned income is already subject to the personal income tax and is relatively easy to count under a negative income tax. In contrast, some unearned income, assets, and net worth that would result in NIT benefit reductions escape taxation under the personal income tax. The decision

to go well beyond the tax system in counting assets and unearned income demonstrates that people do not view government NIT payments as the simple negative of personal taxes.

The competing strands of tax and welfare policy do not translate into a single set of objectives. But, it is possible to list several major goals that underlie policy choices regarding the treatment of assets and nonemployment income.

Maximize equity

The index of equality for tax analyses of horizontal and vertical equity is usually the income of the tax filer, adjusted partly for the number of his dependents. In the NIT context, the notion of "equal treatment of equals" generally means taking into account resources other than income, considering a wider unit than the taxpayer alone, and treating different income sources differently.

Minimize Undesirable Incentive Effects

Making benefits fall sharply with unearned income and some forms of assets lowers the incentive to save and to hold savings in NIT countable assets. Tax policy dictates that NIT should be neutral with respect to these incentives except where the neutrality interferes with achieving other goals.

Minimize the Administrative Burden

This goal requires that the government is able to insure accurate reporting of unearned income and assets at a reasonable cost. It also means avoiding excessive invasions of the privacy of recipients.

Minimize Stigma

The NIT should minimize the extent to which recipients are made to feel that they must declare their poverty before receiving benefits. Part of the appeal of NIT has been that recipients could see themselves as comparable to taxpayers except for their somewhat lower incomes. This would appear to require that NIT recipients not be subject to an entirely different set of rules and procedures.

Prevent NIT Benefits Going to the Wealthy

This goal really means avoiding the bad publicity that would arise from a few "horror" cases. A horror case is one in which a very wealthy person or family receives NIT benefits because their income or assets are in a form that does not reduce the NIT payment.

Maximize Target Efficiency

Maximize the share of NIT's budget costs reaching the poor and near-poor.

Minimize Costs

Limit NIT expenditure to the minimum necessary to achieve adequate income gains for the poor and near-poor.

2. CONFLICTS AMONG OBJECTIVES AND INTERACTIONS AMONG RULES

The problem facing the NIT designer is that he cannot achieve all the objectives simultaneously. As in the case of NIT rules relating to earned income, moves to lower costs and to raise target efficiency tend to weaken incentives. These and other conflicts among goals are inevitable. But, of course, that does not mean that one choice of rules is no better than another. Making sensible choices requires understanding the nature

of the tradeoffs and the interactions among alternative rules defining the treatment of assets and unearned income.

It is artificial to isolate rules relating to assets and unearned income from those relating to earned income and to income guarantees. Consider, for example, the question of whether it is worthwhile to spend more on NIT in order to apply a more liberal set of rules concerning assets and nonemployment income. Before deciding to go ahead with liberal rules on assets, one would have to ask whether the money would be better spent reducing the tax rate on earnings. In a short paper, we cannot consider all interactions. To simplify, we imagine the NIT designer trying to choose what would be the best set of rules for assets and nonemployment income at given levels of expenditures.

The cost constraints set limits on the overall strictness of NIT rules. But within those limits, there is room for considerable variation in specific program features. As Table 5.1 illustrates, one could choose strict or lenient rules for any of several program features. At most levels of budget costs, several alternative combinations of rules would be feasible. To take a simple example, applying a moderate benefit reduction rate to every dollar of unearned income could cost the same amount as applying a high benefit reduction rate to only some sources of nonemployment income. Or, to take another example, one could finance a program with no asset test. and a long accounting period for the same costs as a program with a strict asset test and a short accounting period.

The interactions among program features are important not only for their cost implications, but also for their impact on other objectives. It is worth citing several examples. Even ignoring cost considerations, one

Table 5.1 Alternative Rules for NIT Program Features Affecting the Treatment of Assets and Nonemployment

NIT Program Feature	Strict or Low-cost Policies	Lenient or High-cost Policies
Definition of nonemployment income	Comprehensive; includes all income sources	Narrow; many income sources not subject to benefit reduction
Tax rate on nonemployment income	High, 60% or more	Low, 50% or less
Accounting period	Long, a year or more; some income on accrual rather than cash basis	Short, monthly or quarterly
Filing unit	Wide; includes all members of a household, or at least all related members	Narrow; includes only the individual or the nuclear family
Treatment of assets and net worth	Comprehensive definition of covered assets; low asset limits or high expected rate of exhaustion of assets; no deduction for liabilities or for covered unearned income derived from assets	Narrow definition; excludes many assets; high asset limits or the use of imputed income from assets instead of asset limits; deductions from asset levels for liabilities; deduction from imputed income that income covered as unearned income

would still conclude that short accounting periods are more consistent with assets tests than are long accounting periods. For one thing, assets tests should substantially weaken the incentive to take advantage of short accounting periods by means of intermittent or seasonal employment patterns. For another, one might more reasonably expect families to use their assets to tide them over temporary income deficiencies than to delete their assets over a long period of low income.

Again ignoring cost tradeoffs, it would appear that a narrow filing unit requires a comprehensive income definition more than does a broader filing unit. Suppose we choose a narrow filing unit because we do think it appropriate to presume sharing among people who are not legally responsible for each other. If we still believe it is desirable to take account of actual sharing in order to determine economic positions, we are led to consider private income transfers as part of unearned income. One potentially important application relates to housing. If the NIT counts imputed rent from owner-occupied homes as income, horizontal equity would seem to require including as income the in-kind benefit of living rent-free in a home owned by someone outside the filing unit. One can interpret the rule in SSI that lowers benefits to recipients living with other relatives as resulting largely from SSI's narrow filing unit.

A third example returns us to the income definition-tax rate interaction. The cost tradeoff is only one reason why a high tax rate is more consistent with a partial income definition than is a low tax rate. Since a high tax rate provides a high incentive to misreport income, a high tax rate will make a comprehensive income definition more difficult to administer. Those sources that are especially easy to misreport, like alimony and child support payments, will become candidates for exclusion.

These examples illustrate that one should think of a policy option on the treatment of assets and nonemployment income as a vector of parameters that specify rules for several program features. Each combination of program rules has strengths with respect to some goals and weaknesses with respect to others. The task of the next section is to assess the strengths and weaknesses of the policy choices embodied in several specific NIT proposals.

3. APPROACHES ADOPTED IN SELECTED NIT PROPOSALS

The NIT has developed from an idea into several concrete proposals over the last decade. The first detailed NIT proposal appeared in the Yale Law Review and in reports published by the President's Commission on Income Maintenance. Soon afterwards, President Nixon put forward the Family Assistance Plan (FAP), the first of his two NIT legislative proposals. In the mid-1970s, NIT initiatives came out of Congresswoman Martha Griffiths' Subcommittee on Fiscal Policy and the Department of Health, Education, and Welfare.[2] In addition to these NIT proposals for legislation, there were four NIT experiments for which detailed rules had to be specified.

Although the rules for each NIT are complex, it is possible to describe briefly the basic provisions relating to the treatment of assets and nonemployment income. Table 5.2 lays out the program features for the four major NIT legislative proposals. Note first some important similarities. All four proposals expand the definition of nonemployment income well beyond the adjusted gross income (AGI) concept used in the federal personal income tax. The most quantitatively significant additions to countable income are private and public transfers, pension and annuity payments, and support and alimony payments.

Table 5.2

Program Rules Under Alternative NIT Proposals

	Yale Proposal (Model Statute)	Subcommittee on Fiscal Policy Proposal (ABLE)	Family Assistance Plan (HR1, 92nd Cong. 2nd Sess.)	HEW Income Supplement Program (ISP)
Definition of Income	Comprehensive; concept of income goes well beyond personal income tax definition. Important additions are private and public transfers, pension and annuity payments, and support and alimony payments.	(as Yale)	(as Yale)	(as Yale)
Tax Rate on Nonemployment Income	50%	67%; higher for some public transfers	100% on nonemployment income above the $60 exemption per quarter	50%
Filing Unit	Adult, Spouse, and/or other dependents	Adult, Spouse, and/or other dependents	Related members of household, with at least one unmarried child	Related members of household; independent filing permitted for subgroups which prove economic status
Accounting Period	Calendar year	12 month moving average with carry forward of income over breakeven.	Monthly; HR1: quarterly with carry forward from three prior quarters	12 month moving average with carry forward of income over breakeven.
Treatment of Assets	5% of assets above specified level (less countable income from assets) included as property income. Imputed income for owner-occupied dwelling allows for deduction of mortgage interest.	1-4% of all assets (less countable income from assets) included as property income.	Asset Test: Those with countable assets above $1500 are ineligible. Excluded from countable assets are owner-occupied dwellings; consumer durables, and property essential for self-support up to reasonable levels.	Asset Test: Those with countable assets above specified levels would be ineligible. Excluded from countable assets are owner-occupied dwellings, consumer durables, and property essential for self-support up to reasonable levels.
Treatment of Net Worth	30% of Net Worth above specified level (about $18,000-$20,000 for a family of four) included as income.	No Net	Independent Worth Test	

A second, less exact similarity is the use of time periods for computing benefits that take account of a full year's income. Here the Yale proposal differs from the others in its use of a calendar year instead of a 12-month retrospective period. But, even this small distinction could affect the implementation of assets rules. For example, it is not clear how one could apply an asset test for eligibility purposes (of the type in FAP or ISP) in a calendar year context. Would one be disqualified for the entire year if his assets exceeded the specified levels any time during the calendar year? Or would the applicant lose eligibility for one-twelfth the annual guarantee in any month in which his assets were too high? If the latter, the applicant might fare much better under the retrospective accounting period because then he would need to bring assets down to the eligibility levels only during months in which he claims benefits and not over the full 12-month retrospective period.

Clear differences show up in the way the proposals handle the other program features. The Yale and ISP proposals would apply an equal 50% benefit reduction rate against all income whatever the source, while the ABLE and FAP proposals would reduce benefits more sharply for each $1 of nonemployment income than for each $1 of earnings. The ISP and FAP proposals would employ a broader filing unit than the nuclear family unit used in the Yale and ABLE proposals. This difference could be significant, but it need not be if people would take advantage of ISP's feature allowing independent filing for those who can demonstrate their separate economic status. In terms of the provisions directly related to assets and net worth, the differences are again significant. FAP and ISP both would consider the level of assets only for purposes of determining eligibility. Since many assets are entirely excluded from countable assets, the FAP and ISP assets tests essentially would operate

to disqualify those with small amounts of liquid assets. In contrast, the Yale and ISP proposals take account of a wider range of assets, but do so to reduce benefits on a gradual basis. Both the Yale and ISP proposals would impute some percentage of gross assets as income to the extent it exceeded the income already reported from those assets. The Yale proposal would go beyond the asset imputation and would count as income 30% of net worth above relatively generous disregard levels.

The complete Subcommittee on Fiscal Policy proposal would make an important distinction not obvious from Table 5.2. By relying on refundable tax credits to play a large role in the income maintenance system, it is able to lower the NIT breakeven income and provide many lower-middle-income families with income supplements outside the NIT. Thus, many families who in other proposals would be subject to the NIT treatment of assets and property income would file using the positive income tax's more lenient rules on property income and assets.

4. DEVIATIONS FROM THE INCOME TAX TREATMENT OF ASSETS AND PROPERTY INCOME

All NIT proposals would go beyond the income tax rules in several ways. The most important would be expanding the definition of income, widening the filing unit, raising tax rates, and counting assets and/or net worth. As noted above, these deviations came about when the purpose of NIT shifted away from a simple downward extension of the personal income tax (hereafter PIT) and toward a guaranteed income program which would replace the welfare system. This section examines the rationale for specific deviations from the income tax model.

The authors of the Yale model statute offer good reasons for making the NIT income definition more comprehensive than that used in

PIT. The primary one seems to be that NIT should use the appropriate concept of economic income, even if PIT does not. This is especially so since PIT is inconsistent in its divergences from economic income. Some of these divergences are intended to achieve a set of social and economic policies that the government should not attempt to achieve through NIT. It may be acceptable for high-income people to take advantage of the PIT rules so as to escape taxation, but many fear that making transfer payments to even a few of these people would undermine public support for NIT. A second kind of rationale comes from thinking of NIT as an income guarantee program. Since the primary purpose of NIT is to assure an income floor for the lowest income people, it is appropriate to consider all resources available to a family when determining their benefits. This rationale is becoming the predominant one. In 1968, the authors of the Yale model statute felt they had to justify any divergences between PIT and NIT income definitions. In 1974, the authors of HEW's ISP took gross receipts from any source as their starting point and only allowed exclusions for sources that were unavailable, administratively difficult to check, unwise to include for incentive reasons, or grossly different from society's concept of income.

Some NIT proposals move away from the PIT's general policy of taxing income from all sources at the same rate. For example, ABLE would apply a 67% benefit reduction rate to most nonemployment income sources and a 50% rate to earnings. In fact, this policy is not entirely inconsistent with PIT. Under the federal PIT, the maximum tax rate on employment income is 50%, while the top rate on nonemployment income can climb to 70%; and some state PIT's have taxed earned

and unearned income at different rates. Those NIT designers that have favored higher rates for nonemployment income appear to base their case on the idea that disincentive effects are less serious with respect to nonemployment income than with respect to employment income. A second rationale is that high tax rates on public transfers help offset the uneven distribution of some benefits (such as housing). A third comes from thinking of income as , earned and unearned, literally. That is, those with earnings work harder for their income and are more deserving than those with unearned income.

A technical factor might justify some differential in the tax rates for employment and nonemployment income, i.e., nondeductible expenses required for generating income are probably higher for employment than for nonemployment income. Even if work expenses in the form of transportation, clothing, and lunches were no higher than expenses in generating nonemployment income, Social Security taxes alone would add to the cumulative tax rate on earnings.

Turning to the question of why NIT proposals depart from the PIT in their treatment of assets, we find several justifications. One relates to those assets that yield income in-kind that is not included in the NIT or PIT tax base. Although many durable goods would fit this description, the only example of significance is an owner-occupied dwelling. The Yale authors' rationale for imputing income to homeowners is essentially the same as their rationale for a comprehensive tax base. It is that imputed rent (less expenses) is economic income and should be counted as income whether or not PIT also uses the appropriate policy. A second set of justifications concerns other assets that yield little reportable income because their economic yield is either low or high,

but on an accrual basis only. As in the case of in-kind yields, a high accrued gain represents income and should be counted in some way. Otherwise, some may be able to accrue considerable income while receiving NIT benefits and delay realizing their gain until they are in a lower tax rate bracket. The broader justification is that NIT recipients with high value, low current yield assets could be receiving the market return if they so choose; thus, NIT should pay them as if they received the market return.[3]

Perhaps the most pervasive justification for counting assets in NIT comes straight from the old welfare or charity approach. The idea is that low-income families should exhaust some of their wealth before calling on the government for support. Charity (now in the form of government grants) should go only to those whose needs exceed their resources. It is hard to think of anything close to this kind of principle in PIT.

The NIT proposals reflect these justifications in significantly different ways. The Yale and ABLE proposals take account of assets by considering their income in-kind and their potential returns. ABLE no doubt underestimates these amounts by applying only a 1 to 4% imputation over the first $30,000 of assets. Yale's percentage would be more realistic (5% in 1968 and certainly somewhat higher today). The FAP and ISP proposals would make no attempt to impute income to any illiquid assets. Instead, their rules rely exclusively on the "exhaustion" principle. Only after low-income families use up all but a small amount of liquid, or currently available assets would they receive NIT benefits. This means, of course, that those with low liquid assets but relatively high illiquid assets need not face any asset-related benefit reductions,

while those with a lower total amount of assets might be ineligible if their liquid assets were above the specified level. In other words, families participating in ISP or FAP would not be expected to exhaust any of their illiquid assets. The Yale proposal also would use the exhaustion principle, but in a much more equitable way. Instead of disqualifying those whose assets lie above the exempt level, the Yale NIT would count 30% of the excess as income and reduce benefits by 15% of the excess (after applying its 50% tax rate). A second difference is that the Yale proposal would expect some exhaustion of all of net worth (all assets less all liabilities) whereas the FAP and ISP proposals would expect full exhaustion of some assets, independent of the level of liabilities.

5. EFFECTIVENESS OF NIT ALTERNATIVES IN ACHIEVING GOALS

In principle, one ought to be able to compare the relative effectiveness of the NIT alternatives by examining the tradeoffs among goals. A detailed analysis of this kind is beyond the scope of this paper because many of the relevant numbers are not readily available. It is unfortunate that the designers of NIT proposals only rarely discussed the quantitative basis (if any) for their choice of one rule or parameter over another. Nevertheless, it is possible to assess NIT alternatives using some numbers and some qualitative analysis.

To simplify, we concentrate on the comparison between HEW's ISP and the Subcommittee on Fiscal Policy's ABLE and tax credit proposal.[4] Of primary concern here are differences in the filing unit, the benefit reduction rate on nonemployment income, and the treatment of

assets.[5] The primary tradeoff of relevance here is that the NIT-tax credit proposal reduces the number of people subject to special NIT rules regarding income definitions, filing units, accounting periods, and assets tests at some increase in budget cost.

Turning to comparisons between the Subcommittee's NIT component and the HEW proposal, it appears that their features concerning assets and nonemployment income would involve similar budget costs. The ISP's wider filing unit and more restrictive assets test might save a little more than $2 billion, but ABLE's higher benefit reduction rate on nonemployment income would bring an equivalent $2 billion saving.[6]

On administrative grounds, the ABLE proposal probably has an advantage. The ISP authors argue that ABLE's imputation of income to assets would be far more difficult to administer than the ISP asset limitation, apparently because assets covered under ABLE are difficult to value. While it is true that ABLE would take account of a much wider range of assets, small errors in valuation would be unimportant since they would result in benefit changes of only about $5 per month. The problem of taking account of assets at different times of the year would be less serious under ABLE because changes in the composition of assets would not affect benefits. In contrast, a small error in the measurement of ISP countable assets could mean the difference between eligibility for full benefits and ineligibility. To follow the ISP rules precisely might require checking on liquid assets of some people every month. ISP administrators would face the additional task of insuring that the value of nonexcluded assets did not exceed certain reasonable levels (which would vary by household size). This forces ISP administrators to deal with the very valuation problem ISP's asset limit is designed to avoid.

ISP's filing unit rule grouping all related household members would clearly be more difficult to administer than ABLE's nuclear family plus dependents rule. One reason is that household turnover is much higher than changes in family status. Another reason is that if people did find it advantageous to use ISP's provision for claiming separate household status, it would be exceedingly difficult to assure they were reporting accurately. Whether people maintain separate households is clearly a more subjective question than whether people are married or are legally responsible for each other for some other reason.

Both ABLE and ISP would lower the incentive to save by applying high tax rates on nonemployment income. However, the ISP assets test could have a far more serious impact on savings than the ABLE asset imputation rule. Consider the many families whose incomes are generally adequate, but low enough to receive NIT benefits intermittently. These are the eligible families that have the highest cash savings. When they experience a sharp decline in income, they might find that it is their savings account that keeps them from receiving any NIT benefits. Soon many will realize that it does not pay to keep too much for unforseen declines in income. Where an extra $500 in the bank might yield only $10 instead of $30 per year because of the ABLE tax rate or imputation rule, it might cost $400 or more in lost benefits because ISP's asset limitation makes the family ineligible for a few months.

These kinds of exclusions make ISP clearly less equitable than ABLE. Even the ISP authors admit their asset limitation is inequitable. In order to examine the issues of horizontal and vertical equity systematically, we need an index of equality. One appropriate index is the Hansen-Weisbrod measure of income plus the annuity value of net worth.

Judged by this measure, the ISP would prove highly inequitable because it would pay different amounts to equally situated families and its benefits would reverse the ordering of families. The ABLE proposal would do better than ISP; but it would not be entirely equitable given its higher tax rate on nonemployment income and its imputation based on assets instead of on the annuity value of net worth.

The income-net worth index of equality is also relevant for judging target efficiency. In general, ABLE should achieve more target efficiency than ISP since its rules for scaling benefits are more closely related to the appropriate index. However, if ISP took enough benefits away from the top of the distribution to raise benefits at the bottom substantially, one might argue that ISP's vertical target efficiency is superior. As noted above, ISP's savings through its more restrictive asset test are offest by ABLE savings through its higher tax rate on nonemployment income. Thus, to know whether ISP achieves higher vertical target efficiency, one would have to calculate the distribution of benefit reductions associated with ISP's asset limitation and with ABLE's higher tax rate by income-net worth classes. On this basis, it is not obvious which NIT would produce higher target efficiency.

Either the ABLE asset imputation rule or the ISP asset limitation should be sufficient to assure that no NIT benefits go to the very wealthy. To assure that the wealthy with low liquid assets are excluded from the ISP eligibility, the secretary would have to specify maximum allowable values on homes, cars, and other illiquid assets.

The differential impact on recipient attitudes is hard to judge, although ABLE would seem to have an advantage since its asset imputation relies far more on tax principles than does ISP's. If ABLE participants recognized that an imputed return on their assets reflected income, they might see

nothing stigmatizing in reporting an estimate of their assets and in losing small amounts of benefits associated with their imputed income. On the other hand, the ISP participant would be unable to see in the asset limitation rule any principle other than the idea that people with available resources should exhaust them before turning to the government. If stigma means forcing recipients to declare they are needy as a condition for receiving benefits, then ISP would likely prove more stigmatizing than ABLE.

To summarize, the mix of program features recommended in the ABLE proposal outperforms the mix recommended in ISP. Relative to ISP, ABLE is more equitable, at least as administratively feasible, as target-efficient, more effective in preserving savings and asset composition incentives, less stigmatizing, and as effective at assuring that very wealthy families do not receive benefits.

6. REASSESSING THE TRADEOFFS

The NIT legislative proposals and their justifications are instructive, but they need not limit the analysis. Apparently, all of the NIT designers felt constrained enough to require some form of asset test. But, is one really essential? What would have to be sacrificed in order to avoid an asset test and to adopt a liberal policy on the taxation of nonemployment income? Might alternative program designs--other than a universal noncategorical NIT--avert the need for strict limitations on assets and nonemployment income? In this section, I attempt to piece together some relevant numbers to highlight a few significant tradeoffs. Next, I consider whether covering part of the population

outside NIT might eliminate much of the justification for NIT assets test.

Doing away with assets tests would add to budget costs and might allow a few low income, wealthy families to receive budgets. It is generally accepted that the possibility of a few wealthy NIT cases is a political problem. But, apart from anecdotal evidence, there appears to be little knowledge about the depth of this particular public concern. Moreover, one might argue that just as many citizens would oppose the idea of subjecting large numbers of lower-middle-income families to asset tests or severe penalties to savings. It appears as plausible that the existence of asset tests will undermine public support by assuring that NIT will be seen as welfare, as it is that the absence of asset tests will arouse massive outcries against NIT.

What attitude the public takes will probably determine more about average NIT benefits than will the direct effect on costs of employing an asset test. Although it is clear that taking some account of assets would reduce NIT budget costs, the level of expenditures the Congress devotes to NIT will not necessarily be independent of the NIT treatment of assets. However, since this effect could go either way, we assume that the NIT budget allocation is fixed.

How would the benefits from removing the asset test compare with the effects of cost reductions imposed elsewhere? The ISP authors estimate that eliminating the asset test would add (in 1979) about $2.2 billion to benefit payments and about 4.8 million to the number of participants. The new participants would receive about $460 per person,

or about 55% of ISP's average per person payment. The figures indicate that the group that would be excluded on asset grounds would have incomes about $2000 per year higher than the nonexcluded group (assuming the same 2.6 unit size for both groups). But, the excluded group's income would still lie near the poverty level. The high gains in benefits for this group would have to be offset by benefit reductions for others; the reductions could be 5 to 10% smaller than the gains because removing the assets test would yield administrative cost savings. Suppose we chose to lower the ISP income guarantee in order to save the necessary $2.1 billion. Because the breakeven income would decline along with the guarantee, some families would become ineligible for small amounts of benefits; others would face a reduction of about $70-75 per person, or about 8% of their original benefit.

One alternative to lowering the income guarantee is to raise the tax rate on nonemployment income. Figures from the Subcommittee on Fiscal Policy's report show that a rise from 50 to 67% would cut program costs by about $2.2 billion (assuming income guarantee levels of about $3600 per family of four). The cost savings would undoubtedly be higher for ISP, which, unlike ABLE, would supplant SSI and cover the aged, blind, and disabled. The reason is that the elderly receive more of their pre-NIT income from sources other than employment than do other NIT recipients. Thus, 60% would be a plausible estimate of the nonemployment tax rate required to offset the removal of the asset test.

Still another alternative might satisfy those who object to the assets test for its categorical, inequitable features. Imputing a moderate 5% of net worth as income and taxing this income at 50% would save far more than the $2.2 billion. Extrapolating the 1962 wealth figure from the Federal Reserve survey indicates that the net worth

of people covered by NIT would average about $15,000 in 1976. This figure represents the equity in the filing unit's home, automobile, business or profession, and liquid or investment assets. It does not include personal effects or other miscellaneous holdings. Were NIT able to capture the full 2.5% (the 50% tax rate times the 5% imputations), the budget cost savings would come to about $4.6 billion. If we assume underreporting of 25%, the imputation rule would still leave NIT with a net cost saving of about $3.4 billion.

This latter exercise demonstrates that a seemingly lenient asset rule may prove more cost-effective than a strict one. The tradeoff between asset rules is similar to the tradeoff between the tax rate and the definition of income. Making the definition of income or assets more comprehensive permits sharp reductions in the tax or imputation rate.

The frequent argument that imputing income to a comprehensive definition of assets is too difficult administratively is far from convincing. If the standard of comparison is the impact of an administrative rule on the size of the error in a family's benefit payment, then the imputation feature should do no worse than normal income reporting. It is often overlooked that, given a 5% imputation of assets and a 50% tax rate, it would take a $20 mistake in measuring assets to yield the same benefit error as a $1 mistake in earned or nonemployment income. Thus, $500 in unreported income would be equivalent to $10,000 in unreported assets. Looked at in this way, the imputation procedure should lead to no higher benefit error than the taxing of other income. And, it is plausible that a strict limitation on liquid assets could well do worse;

for here, a mistake of a few dollars could lead to a benefit error of a few hundred dollars.

Experience from the rural income maintenance experiment is consistent with these arguments. In spite of the fact that assets would be particularly hard to measure in a rural and farm setting, a comprehensive asset imputation rule would have accounted for less benefit error than the tax on income. In an assessment of the accuracy of self-reported numbers used for payment purposes as compared to edited numbers from detailed quarterly interviews, Harrar found that the asset reporting error ranged from 14% in North Carolina to 27% in Iowa; but, were a 5% imputation applied to all assets, the benefit error in Iowa would have averaged only about $50 per year. In comparison, the benefit error from income misreporting was apparently much higher. The underreporting of net farm income averaged about 40%, implying benefit overpayments in the hundreds of dollars. Even if wages, 90% of which were reported, had been the dominant source of income, the benefit error would still have exceeded that coming from the asset imputation rule. Underreporting of 10% times an average of $5000 per year would mean an overpayment of $250.

The data from Harrar's paper also indicate that the liquid assets test may be more difficult to administer than the imputation rule. In Iowa, where the error in assets reporting was far higher than in North Carolina, the biggest gap between reported assets and the levels determined in quarterly interviews was in liquid assets. Moreover, the liquid assets question appeared to arouse more objection by recipients than other questions about assets. It is hard to escape the conclusion that the case for liquid asset rules over asset imputation rules is dubious at best and probably incorrect.

These tradeoffs all relate to the treatment of assets and nonemployment income under a universal, noncategorical NIT. Relying on other programs to cover some population groups might alter the tradeoffs considerably. For example, suppose all elderly qualified for at least some minimum Social Security payment instead of for an NIT grant. Since much of the cost reduction from employing an ISP-type assets test accrues because of relatively high asset holdings among the elderly, an asset test in an NIT program that does not deal with the elderly might save few or no budget dollars (after increased administrative costs).[7]

7. SUMMARY AND CONCLUSIONS

This paper has two main themes. The first is that the NIT treatment of assets and nonemployment income is an example of how NIT designers attempt to reconcile tax policy and welfare policy concepts. The second is that any assessment of alternative policies should take account of several goals and consider asset rules in the context of other program features.

The interaction of tax and welfare policy concepts arises immediately with the specification of objectives. In addition to traditional tax goals of horizontal and vertical equity and administrative efficiency, NIT designers must consider such welfare-oriented goals as assuring that no benefits go to the wealthy and maximizing the share of NIT expenditures on the poor.

Whether one is led to assets tests from the welfare or tax perspective can make a great difference for the form of the assets test. For example, much in the Yale NIT design is motivated by tax policy considerations. Imputed in-kind income from home ownership is the appropriate policy if

one is to achieve horizontal equity. The Yale authors view wealth as an additional tax base on which it is proper to levy a tax or benefit reduction. Thus, they provide for imputing income from some assets and lowering benefits gradually with net worth. In contrast, the ISP authors begin by favoring tax policy as a guide, but quickly move toward a welfare focus. Rather than defining nonemployment income as the tax concept with limited exceptions, the ISP designers take gross receipts (similar to "resources" in welfare terminology) and only exclude those sources that are difficult to handle administratively. Administrative convenience and the fear that a few wealthy people might receive NIT benefits cause the ISP designers to choose an assets limit test of the type in current welfare programs.

To deal directly with alternative policies, section 5 compares several relevant features of the ABLE (Subcommittee on Fiscal Policy proposal) and the ISP plans: ABLE places a 67% benefit reduction rate on most private nonemployment income while ISP uses only a 50% rate. Asset treatment differs substantially. ISP would exclude from eligibility all units whose liquid assets are above some allowable levels. For those below these limits, the extent of asset holding would have no effect on benefits. ABLE would count 1 to 4% of assets as income to the extent this imputation exceeded nonemployment income already included from these assets. Our assessment concluded that the ABLE rules had clear equity and incentive advantages that were not offset by the expected administrative advantages of ISP. Although the ABLE rules would require some valuation of all assets while the ISP rules would generally call for only a limited valuation, the ISP rules might be harder to administer than the ABLE rules. The primary reason is that even large measurement errors would cause only slight benefit

errors under ABLE while ISP administrators who make small mistakes could cause substantial benefit errors.

This latter point is pursued further in section 6 in the examination of overall tradeoffs in the treatment of assets and nonemployment income. Here, we note that imputation rules are likely to be no more difficult to administer than rules requiring benefit reduction rates on earned income. Given a 5% imputation of assets and a 50% benefit reduction rate, it would take a $10,000 mistake in measuring assets to yield the same benefit error as a $500 mistake in measuring income. Evidence from the rural income maintenance experiments indicates that the asset imputation rules caused lower benefit errors than occurred because of income misreporting.

The clear implication of these results is that NIT designers need not move toward the policies of welfare-oriented programs in the treatment of assets and nonemployment income. An assets test is not essential in order to save costs. As reported in section 6, the cost increases from not counting assets can be offset by a higher tax rate on nonemployment income or a slightly lower benefit level. But, where taking account of assets is desired for purposes of equity, target-efficiency, and assuring that no benefits reach the very wealthy, an asset or net worth imputation rule is superior to an asset limit rule. First, a 5% imputation on all net worth (which is in turn taxed at a 50% rate) would yield higher cost savings than the ISP asset limit rule, even if we assume that 25% of net worth would go unreported. Second, the imputation rule is clearly more equitable. And finally, the imputation rule is likely as easy or easier to administer than the asset limit rules. The usual arguments to the contrary rest on an improper standard of comparison. If one judges administration by the extent of benefit error at a given administrative cost, then even the administrative justification for using an asset limit rule fails.

NOTES

[1]This formulation was put best to the author by Robert Lampman.

[2]The Subcommittee NIT proposal was called Allowance for Basic Living Expenses (ABLE); the HEW proposal was called Income Supplement Program (ISP).

[3]If this principle were extended to human wealth, it would follow that NIT should pay workers no more than the amount they would receive if they earned the average return to their skill. In this connection, some authors have argued that payments should depend at least partly on earnings capacity rather than entirely on actual earnings.

[4]Although the Subcommittee proposal would leave SSI intact, here we assume it would replace SSI in order to highlight the design differences in the two proposals.

[5]Another distinction is that the Subcommittee plan is a combined NIT-tax credit program while the HEW plan is a pure NIT.

[6]These figures are extrapolated from the papers spelling out the two proposals. But they are certainly only approximations.

[7]Of course, one would not want to adopt the minimum Social Security approach on this basis alone. The conventional view against this policy has been that high Social Security minimum benefits permit excessive transfer payments to go to aged with low past covered earnings, but moderate or high current income. But, as Jack Habib and I show elsewhere, a single tier Social Security-type program need be no less target efficient than a combined Social Security-NIT approach; and the social security-type program may well be superior in other respects.

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Housing Assets as Potential Income: Implications for Income-Conditioned Programs

Yung-Ping Chen

It is generally recognized that current money income is an important measure of a person's economic circumstance. But, since persons with the same current money income may hold widely different amounts of assets, the assessment of economic status based on current money income without consideration of net worth (assets less debts) is inadequate. A better measure would be to combine potential income from net worth with current money income.[1] Potential income from net worth would be derived by converting the stock of net worth into a flow of monthly income for life, annuitizing the value of net worth according to assumptions on interest rate, mortality experience, and other factors.

This income plus net worth approach through annuitization has not met with universal acceptance. Some object to it on conceptual or practical grounds; others are concerned with the implications it raises for social welfare programs and their recipients because many such programs include assets or income from assets in establishing eligibility and/or determining benefit amounts.

This paper has four tasks: to analyze a conceptual objection to the income plus net worth measure of economic welfare; to show the effects of a proposed Housing-Annuity Plan (HAP) and of annuitizing net worth on the income status of households in different age groups; to deal with the complaint that the annuitization approach is impractical; and to consider the implications of participation in HAP in regard to eligibility for and amount of benefits receivable by elderly homeowners from social welfare programs.

1. ANALYSIS OF A CONCEPTUAL OBJECTION

Projector and Weiss (1969) have criticized the annuitizing concept by pointing out its various deficiencies. They ask two questions: Is a measure of economic welfare that incorporates net worth necessarily better than an income measure? and Is a measure of economic welfare that spreads net worth evenly over the remaining life span better than a measure that incorporates net worth in some other fashion? Their argument is that a measure of economic welfare that includes net worth will simply induce the poor not to accumulate any assets. I am doubtful of this argument for several reasons.

Some individuals who have low incomes in one particular year are actually reasonably well-off. As an extreme case, one family in the Survey of Financial Characteristics of Consumers (SFCC) who had a negative income in 1962 had a net worth of over $1 million (Federal Reserve Board of Governors 1966). This family was involved in speculative ventures and had simply had a bad year in 1962. The point is that there are people who are poor only on a transitory basis.

Projector and Weiss do not offer any empirical evidence for the argument that an annuitizing approach would inspire everyone to quickly consume his/her assets in order to become eligible for welfare. Admittedly it is difficult to gather information about how many people would be willing to change their habits just to get on the welfare rolls. However, as an attempt to answer this question, we can analyze certain characteristics of those poor families who were elevated above the

Social Security Administration poverty benchmark incomes by annuitizing net worth at a 4% interest rate. Table 6.1 shows some pertinent characteristics of these 2.144 million households, based on the SFCC data.

Almost two-thirds of those helped were the aged. Are these persons going to change a lifetime of living habits just to be on welfare in their old age?

Nearly two-thirds of those helped were homeowners. Is it likely that persons inclined toward homeownership are going to forego it just to qualify for welfare?

More than two-thirds did not work at all in 1962. Should we worry whether annuitization would cause people to give up work? Most of those helped had already quit working. In fact, the vast majority of these people were not working because they had retired, which correlates with the number of persons over age 65 in the sample.

Over three-fourths of these families had assets of more than $10,000, and over one-third had assets worth more than $25,000. Five percent had more than $50,000. Obviously, everyone who appears in the poverty statistics is not necessarily poor when assets are considered. Is it likely that these people would cease to accumulate assets or consume them rapidly in order to receive welfare?

In summary, we see that the typical household helped by annuitization is an elderly retired couple with a reasonable amount of assets. It is doubtful that these people would have significantly altered their lifestyles.

Projector and Weiss also state that the College Scholarship Service (CSS) "rejects the simple annuity method because of the burden it would place on older parents [p. 17]." They try to justify why the CSS reacts in

Table 6.1. Characteristics of Households Whose Incomes Were Raised by Annuitizing Net Worth

	Number in Millions	Percent
Age of Head		
Under 35	.075	3.5
35-54	.216	10.1
55-64	.505	23.6
65 & over	1.348	62.9
Marital Condition		
Single men	.743	34.7
Single women	.234	10.9
Married couples	1.167	54.4
Size of Household		
Single person	.947	44.2
Two persons	.863	40.2
Three or more persons	.334	15.6
Housing Status		
Renter	.531	24.8
Homeowner	1.414	65.9
Farmer	.199	9.3
Number of Months Worked		
None	1.478	69.0
1-6	.066	3.1
7-12	.600	28.0
Occupation of Head		
White collar	.401	18.7
Blue collar	.204	9.6
Retired	1.222	57.0
No occup. in 1962	.317	14.8
Education of Head		
1-6 years of school	.661	30.8
7-11 years of school	.921	42.9
High school graduate	.343	16.0
Some college	.219	10.3
1962 Net Worth		
Under $5000	.167	7.8
5000-9999	.385	18.0
10,000-24,999	.838	39.1
25,000-49,999	.645	30.1
50,000 & over	.109	5.1

exactly the opposite manner to that which an income plus net worth measure suggests. They agree with CSS, which finds "the younger unit 'better off' than the older because the assets of the younger unit will continue to grow and those of the older unit will not [p. 17]."

While younger persons may have the prospect for savings, is the savings potential guaranteed? It may be misleading to base eligibility for financial assistance upon what might happen in the future rather than upon what definitely happened in the past. Moreover, Projector and Weiss are comparing noncomparables. In effect, they are comparing the economic condition of a 40-year old person when he or she reaches 60 with that of a person who is 60 today. The time dimension is critical here, for we must decide which of these two people to assist now. It is probable that in 20 years the first person will be better off than the second is today; however, the younger person is entitled to assistance because, by the income plus net worth criterion, he or she is the poorer of the two.

2. EFFECTS OF NET WORTH ANNUITIZATION ON CURRENT INCOME

The importance of net worth in terms of its potential contribution to current income increases with age, rising from a mere 2% for those under 35 to more than 77% for those 65 and over, as shown in Table 6.2 (Federal Reserve Board of Governors 1966). Although annuitizing net worth generates additional income for all age groups, homeowners and nonhomeowners alike, by far the largest addition to current income is estimated for the aged, both in absolute and relative terms.

Table 6.2. Contribution of Net Worth to Current Income

Age of Head	Mean Current Income	Improvement in Income by Annuitizing Total Net Worth	
		Amount	Percent
Under 35	$6,468	$ 154	2.4
35-54	8,330	862	10.3
55-64	6,426	1,978	30.8
65 and over	3,714	2,875	77.4

For a variety of reasons, we may wish to focus our attention on the aged. Theoretically, a person's income position would be improved if the measurement included net worth as well as income. Pragmatically speaking, our study of potential income from net worth is for the purpose of examining its contribution toward economic well-being by extending budgetary constraints of persons involved. Therefore, potential income becomes meaningful only when it may be an effective means of augmenting incomes.

According to the data in Table 6.2, those in the under 35 and 35-54 age groups could not much improve their income positions because annuitized income represents only a small addition. For the 55-64 age group, the increment due to annuitization is substantial, but this may not be the group of persons who would require augmentation of their current income through annuitization. For the aged, however, the circumstances are quite different: Their earnings potential is in general severely limited, and many of them have low and sometimes inadequate current income. For the 65 and over age group, therefore, net worth annuitization may be a welcome procedure.

The forms of wealth included in the Survey of Financial Characteristics of Consumers are ownership of home, automobile, business or profession (farm and nonfarm), liquid assets, and investment assets. These items hold different degrees of importance in the portfolio of older persons, and not all of these assets are amenable to conversion into cash.

Ownership of a home is often the single, most important asset an aged person holds. One method to transform home equity into currently spendable income is that of the Housing-Annuity Plan (HAP) to be discussed in the next section. This plan is a suggested financial mechanism whereby an elderly homeowner may, on a voluntary basis, convert the home equity into a life annuity (made available by an issuing agency) with guarantee of lifetime tenure in the house. This is not simply a hypothetical measuring instrument, but could become a practical plan as well, a subject we return to in the next section.

To what extent would HAP improve the income status of the elderly homeowners? Table 6.3 shows the potential income from homeownership for the four age groups.[2]

Table 6.3. Potential Income From Homeownership

Age of Head	Median Current Income		Median Housing Annuity Income		Improvement in Income by Annuitizing Homeownership	
	1962	1971	1962	1971	1962	1971
Under 35	$6,950	$11,920	$ 70	$150	1.0%	1.3%
35-54	8,660	14,980	200	385	2.3	2.6
55-64	6,550	10,490	363	603	5.5	5.8
65 & over	2,780	4,690	490	827	17.6	17.6

Since the potential income from homeownership is what is being investigated, the median current incomes and improvements in incomes are presented for homeowners only. It is clear from these numbers that, although homeowners in all age groups would experience improvement in income, elderly homeowners would benefit the most, both in absolute and relative terms in both years. It is also remarkable that percentage improvements in income in 1971 were virtually identical to those in 1962.

While the improvement in income is about 17.6% for the aged homeowners as a group, the poor (according to Social Security Administration income benchmarks) may expect a much higher percentage improvement relative to the nonpoor homeowners, as Table 6.4 indicates.[3]

Table 6.4. Improvement of Income for Homeowners

Poverty Status	Median Current Money Income		Median Housing Annuity Income		Improvement in Income	
	1962	1971	1962	1971	1962	1971
Poor aged	$ 880	$1,620	$371	$490	42.3%	30.3%
Nonpoor aged	3,900	5,520	562	880	14.4	15.9

Tables 6.3 and 6.4 show the income potentials of annuitizing home equity. Although it is a very important form of wealth, home equity is only one of the several components of total wealth. It is necessary therefore to examine the relative importance of annuitizing home equity and total net worth for the poor in different age groups.

For the poor, the great bulk of net worth consists of home equity. Moreover, when we study the composition of net worth held by the households,

we find a number of cases where the annuitized income from total worth is actually lower than the annuitized income from home equity alone. This somewhat surprising result is caused by the existence of households with positive net worth but negative nonhouse net worth. The relative significance of annuitizing only home equity versus annuitizing total net worth is shown in Table 6.5, with respect to the poor households in different age groups.[4]

Table 6.5. Home Equity Versus Total Net Worth

Age of Head	Median Housing Annuity as Percentage of Median Current Income	Median Total Net Worth Annuity as Percentage of Median Current Income	Median Nonhouse Net Worth Annuity as Percentage of Median Current Income
Under 35	1.3	1.1	-
35-54	4.5	5.7	-
55-64	22.7	28.0	7.2
65 & over	42.3	56.4	6.8

For the younger poor households (those under age 54), current money income would increase little whether home equity alone or total net worth were annuitized. For all practical purposes, potential income from net worth other than the home equity (nonhouse net worth) is virtually nil. For the older poor households (those 55 and over), the great bulk of addition to current income comes from annuitized home equity. While the nonhouse net worth contributes toward raising the income status of these older households, the improvement factors, around 7%, are not substantial.

Even though we stated earlier that HAP would be more attractive to the aged poor because it would mean relatively large improvements in

their incomes, it is nonetheless useful to examine how much HAP would increase the incomes of the elderly nonpoor in different income brackets, as shown in Table 6.6.[5]

Table 6.6. Effect of Housing-Annuity Plan on Incomes of Elderly Nonpoor

Money Income Group	Median Housing Annuity	Median Housing Annuity as Percentage of Median Current Income
Less than $3,000	$ 469	19.8
3,000-7,499	571	14.5
7,500-24,999	731	6.1
25,000 & over	1,765	3.9

Although those elderly homeowners in the highest income group are estimated to receive a substantial amount of housing-annuity income, it represents a very small increment to their current income. Table 6.6 shows that, even for the elderly nonpoor, potential income from homeownership would increase current income by more than 15% for those in the $3000-7500 income group, and nearly 20% for those in the under $3000 (yet still nonpoor) group.

The literature on the income position of the aged consistently reveals that single or unrelated elderly individuals are much poorer than married elderly couples. Table 6.7 indicates that the single homeowners would receive relatively much greater housing-annuity income than would the married elderly couples.[6]

Table 6.7. Housing Annuity Income for Elderly

Marital Status	Median Housing Annuity	Median Housing Annuity as Percentage of Money Income
All	$ 490	17.6
Married couples	454	13.9
Single men	1,037	51.2
Single women	464	38.9

These estimates suggest a commendable result of a plan, such as HAP, to convert home equity to currently spendable income.

The preceding discussion centered around the improvements over current money income which HAP would represent for the elderly in different age, income and poverty-status, and marital-status groups. Another means of suggesting the contribution of net worth to economic well-being would be to demonstrate the reduction in the incidence of poverty among the aged if potential income from net worth were added to current money income. The realization of potential income requires the liquidation of net worth through annuitization. Even in the absence of plans to convert net worth into annuities, homeownership yields imputed rent. The incidence of poverty among the elderly would decline if imputed rent alone were added to current money income.

The following tabulation shows the proportions of the aged who were poor in 1962 by the Social Security Administration standards, under five different income measures:[7]

	Married	Single
1. Money income only	20.2%	62.5
2. Money income plus imputed net rent	18.7	54.1
3. Money income plus annuitized net worth (excluding home equity)	17.5	53.2

4. Money income plus annuitized net worth (including home equity)	13.8	44.7
5. Money income plus annuitized net worth (including home equity) and imputed net rent	8.8	38.3

These percentages amply suggest the significant and even dramatic reductions in the incidence of poverty as the income definition is broadened from 1 to 5.

3. THE HOUSING-ANNUITY PLAN

The idea of converting home equity into current income was proposed a number of years ago (see National Tax Association 1965; Lindholm 1967). The income potential from homeownership was discussed in the previous section in terms of the proposed Housing-Annuity Plan. Why was such a new financial instrument necessary?

The ability and willingness of an older homeowner to use home equity for augmenting current income poses a dilemma under existing circumstances. Conversion of a home into cash requires its sale, and this approach may not be agreeable to some due to psychological and social adjustment problems. In addition, by selling his or her home, a person becomes a renter, paying rent with the proceeds from sale. Doubling-up with young members of the family--thus avoiding rental payments--is becoming more the exception rather than the rule.

Another solution would be to borrow against home equity. But conventional modes of financing homes would, for the most part, preclude older persons from using their homes as collateral. The primary reason is the lending institutions' deep concern with problems of default and foreclosure.

Even if funds became available by selling the house or borrowing against it, the stream of such future income may not be dependable or certain because of changing economic conditions. If the proceeds were deposited in banks or savings and loan associations subject to periodic withdrawals, the possibility of exhausting the funds increases with time. Therefore, in order to provide a kind of security for older individuals, the proceeds are best used to purchase an annuity. However, under present institutional arrangements, an aged homeowner has to sell his home in order to purchase an annuity with cash. What, then, could be done to resolve the dilemma, guaranteeing that an elderly person may utilize his or her lifetime savings in the form of home equity without sacrificing the preference to live in his or her own home?

This dilemma may be resolved by the proposed Housing-Annuity Plan.[8] HAP combines home sale and annuity purchase. Assured of lifetime occupancy of his or her house, the elderly homeowner (called the housing annuitant) would put the house in escrow to convey its title to the financial organization (called the issuing agency) at the time of the homeowner's death or that of the surviving spouse in exchange for a monthly income for life. The amount of the annuity would be based on such economic, actuarial, and cost-accounting considerations as rate of interest; rate of appreciation of property value attributable to the lot; homeowner's age, sex, and marital status; net equity in the property; and expense loading. The effects on annuity income of all these factors (except expense loading) have been discussed elsewhere (see Chen and Giles 1969).

Once the housing annuitant voluntarily enters into such agreement, he receives annuity income for life in addition to lifetime tenure in the house. If

he or she is married, such income continues until the death of the surviving spouse. Should he or she desire to change residence after having entered into such a contract, however, he or she would have the option of selling the home to a third party (thus repaying the insurer the total sum of annuity payments received to date plus interest) or of conveying title to the issuing agency (thus receiving additional annuity payments).

Any mortgage outstanding would be deducted from the estimated value of the house and the annuity computed on the net equity. The problem of property value changes could be resolved by a variable annuity arrangement or a renegotiation clause for adjusting annuity payments.[8] To prevent frequent reappraisals, a plan might be created whereby the Federal Housing Administration (FHA), for example, would guarantee the property's value over its economic life in return for an appropriate insurance premium. Thus, the housing annuitant would not face the prospect of reduced annuity incomes; an assured level of income would provide some measure of security.

This plan has the merit of a completely voluntary agreement in full accord with freedom of choice, serving to increase the options of older people regarding housing accomodations and sources of income. Being a supplemental source of income, HAP would offer a degree of flexibility in planning retirement income, which would extend to the choice of housing as well.

So much for the merits. There are also problems in setting up HAP, but none of them seem insurmountable. Since the exhaustion of home equity at life's end is clearly the consequence of this plan, objections may involve bequests and inheritance. However, since we expect low-income elderly homeowners to join it, the plan is more likely to relieve their children of financial responsibility during their parents' lifetime rather

than deprive these children of a meaningful legacy. Also, the adult children probably would be pleased with the improved standard of living of their parents.

Since the housing annuitant eventually will relinquish his home, there may be little incentive for keeping up with repairs and maintenance. Three points should be noted on this reservation. First, in view of the renegotiation clause mentioned above, incentives exist for maintenance because a higher annuity may result from a greater house value. Second, we propose that a house maintenance division be established in the issuing agency in order to provide or arrange a low-cost maintenance service. Third, since the current income of the housing annuitant increases with HAP, he is more able to afford the cost of maintenance.

The problems commonly associated with appreciation and depreciation of property values could create additional objections to the plan, but measures such as those indicated earlier (variable annuity approach, renegotiation clause, FHA guarantee) or others would alleviate these difficulties.

One important consideration involves the financial intermediary that would undertake HAP. Since an annuity plan is proposed here, life insurance companies may be the logical institutions; but since the proposal involves homes, savings and loan associations may be even more concerned. Since HAP is intended as a source of additional income in retirement, pension funds may likely serve as well; but since sales of homes will take place, realty agencies would be interested too. We conjecture that a consortium involving all of these organizations may well be established to implement HAP.

Another consideration relates to the premium, which is paid at the end instead of at the beginning of the contract. Thus, the cost of this type of lending would be high, resulting either in a low return to the issuing agency or a small monthly payment to the housing annuitant. This suggests that loan funds from the government may be needed in order to start the plan. Once the plan gets underway, sales of houses are expected to occur within a few years and the government loan could be repaid with interest. The plan would then carry forward on its own.

With HAP, the elderly would be keeping their houses for their own use longer than otherwise. It may be argued that homeownership of the aged should not be encouraged because they may be "over-housed" that is, homes owned and occupied by the elderly could be better used by younger families with children. While there is merit in this argument, it ignores the psychological and social factors involved in homeownership. Moreover, even though HAP enables the elderly to remain in their own homes, they are by no means locked into such a housing accomodation. We anticipate that HAP will serve the function of easing the transition from work to retirement. Retirement already entails a number of adjustments, and these adjustments would be made more difficult if housing accomodation requires changes as well. In a few years' time, however, the retired may be well adjusted in retirement and ready to change their housing; or health considerations may dictate an alternate mode of living quarters. As indicated earlier, the housing annuitant under HAP has the option of selling his or her home before the HAP contract is lived out. Moreover, if the aged do sell their homes earlier than when HAP is available, they would compete against younger persons for apartment dwellings.

Reference was made earlier that, since HAP generates additional income, dependency on public transfer payments would be reduced. As such, HAP raises an issue of how it will affect the operations of social welfare programs that are income-conditions. At present, house value is not used in establishing eligibility for the Supplemental Security Income. With reference to the argument that the aged should not be encouraged to hold onto their homes, what will happen to eligibility for SSI when the welfare recipient's cash income increases from the sale of his or her home, since cash income level is used in establishing eligibility? This important question will be discussed in the next section.

A considerable period of time has elapsed since the HAP idea was first proposed. There has been increasing interest in the plan in the financial community. For example, in a congressional testimony, Stuart Davis (Davis and Montgomery 1976), Chairman of the Board and Chief Executive Officer stated:

> A housing annuity option should be provided to enable the retired family to use its equity without being forced to uproot themselves and establish a new way of life. One of the major housing problems in the United States today is the older family with a high equity in its home, but whose cash income is inadequate to pay for insurance, taxes and maintenance. Why shouldn't the lender contract to pay them a specified sum per month out of the value of their equity for the rest of their lives or until they sell their home in their own good time [p. 5]?

Preston Martin, President of PMI Mortgage Insurance Company, formerly California's Savings and Loan Commissioner, and Chairman of the Federal Home Loan Bank Board has advocated the idea. Using the acronym of RAM in place of HAP (for Reverse Annuity Mortgage), following the terminology of the Federal Home Loan Bank Board task force on alternative mortgage instruments, Martin (1977) writes:

> This mortgage design is specifically intended to supplement the income of retired persons that have paid off their mortgage, but who do not want to move.

> With a reverse annuity mortgage, the lender would pay the borrower a fixed monthly annuity, based on a percentage of the current value of the property. In effect, the homeowner would borrow against the equity in his home. The annuitant would not be required to repay the loan until his demise, at which time the loan would be discharged through probate. No cash payment of interest would be involved, as the increase in the loan balance each month would represent the cash advanced, plus interest on the outstanding balance.

We are also pleased to report that several life insurance companies in England have offered HAP-like contracts for a few years now. Their contracts carry different names, such as House and Income Plan, the House-Owner's Retirement Income Scheme, and the like. Table 6.8 lists the essential features of the British schemes.

4. THE HOUSING-ANNUITY PLAN'S IMPLICATIONS FOR INCOME-CONDITIONED SOCIAL WELFARE PROGRAMS

A high percentage of the elderly poor participate in more than one social welfare program in which either eligibility or benefit amount is determined by the economic circumstances of the applicant. The criteria for measuring economic circumstances vary from program to program. There appear, however, three primary bases upon which eligibility or benefit amount is conditioned: (1) countable income; (2) value of certain assets or resources; and (3) eligibility or participation in certain other social welfare programs. Some social welfare programs have only income tests; others have income and asset tests; some only require eligibility for or participation in certain income-tested or income-and-asset-tested programs; and still others have different combinations of requirements. Since HAP generates income and since the low-income older persons are most likely candidates for the plan, the implications of HAP income on

Table 6.8 Housing Annuity Plans in England[a]

	Equitable Life	Hambro Provident	Home Reversions	MGM Assurance	Save and Prosper
Minimum age limits	Single male-65 Single female-65 Joint life-about 70	Single male-65 Single female-68 Joint life-72	Single male-69 Single female-69 Joint life-69	None officially, age 65 viable limit	Single male-70 Single female-70 Joint life-75
Type of property	Post-1919 freehold property or leasehold if unexpired term is at least 65 years; converted flats & maisonettes not suitable	Any freehold property or leasehold house or flat if unexpired term is at least 80 years; converted flats and maisonettes not suitable	Freehold property or leasehold if unexpired term is at least 50 years	Freehold property only, but building society will take leasehold from investing members	Any freehold property or leasehold flat if unexpired term is at least 50 years
Minimum valuation	£13,500	£10,000	£10,000	£10,000[b]	£10,000
Loan					
Maximum % of valuation	75%	80%		60%	75%
Minimum/maximum loan	£10,000/25,000	£8,000/25,000	Not applicable	£1,000/18,000	£7,000/25,000
Interest rate	6% p.a. gross, fixed at outset	Plan A-9% p.a. plan B-6% p.a. plan C-7% p.a. gross fixed at outset	Company buys property outright; minimum/maximum purchase price £10,000/45,000	Varies throughout term, currently 13% p.a. gross	6% p.a. gross, fixed at outset, but 7% p.a. gross if initial cash sum taken
Annuity					
Payment mode	Monthly in arrears	Monthly in arrears	Monthly in advance	Usually monthly in arrears	Monthly in arrears
Guaranteed period	None	None	5 years	None	None

Table 6.8--Continued

	Equitable Life	Hambro Provident	Home Reversions	MGM Assurance	Save and Prosper
Income per £10,000 loan for basic rate tax payer					
Male age at entry					
70	£ 556	£ 556 *	£ 576 **	£ 762	£517 *
75	819	819	773	1,039	775
80	1,199	1,196	1,112	1,414	1,080
Female age at entry					
75	582	582	588	793	540
80	873	873	855	1,108	881
85	1,300	1,300	1,146	1,393	1,300
Joint lives (male elder)					
80/77	534	497	569	703	455
85/82	813	752	832	912	681
90/87	1,187	1,122	1,121	1,167	1,010
Charges to houseowner					
Valuation fee	According to sliding scale: in case of 10,000 loan £33.50; 20,000, £57, but returned if plan completed	£30 on property valued at 10,000 plus £2.20 for each additional £1,000 but returned if plan completed	Based on building society rates, e.g. £10,000 valuation, £25; £20,000, £47, but returned if plan completed	Payable by houseowner, not returnable on completion of plan	£25, but returned if plan completed
Deduction from initial loan	None	None	Not applicable, but a nominal rent of £12 p.a. is payable	None	1%

Table 6.8--Continued

	Equitable Life	Hambro Provident	Home Reversions	MGM Assurance	Save and Prosper
Other features					
Benefit from appreciation in house price	If value of house rises substantially, further advance may be negotiated at prevailing rates	If value of house rises by at least £2,500, further advance may be negotiated at prevailing rates	None, property owned by company	If value of house rises substantially, further advance may be negotiated at prevailing rates	If value of house rises by at least 5,000, further advance may be negotiated at prevailing rates
Premature repayment of loan	No charge	No charge	Not applicable	Charge may be levied[c]	Charge may be levied[d]
Clearance of advance	Mortgage repayable within 6 months of death; after death, interest charged at 3% p.a. above Minimum Lending Rate	No specific time limit; after death, interest charged at 3% p.a. above National Westminster Bank base rate	Not applicable	No specific time limit; current mortgage continues to apply to loan	Mortgage repayable within 6 months of death, after which interest charged at 'normal commercial rates'

[a]Source: Planned Savings, 1977, pp. 21-25.

[b]But depends on the property. Loan also limited by the fact that the interest payments must not exceed 25% of total gross income per annum of householder, to which may be added the payments assumed to be made under the annuity to be effected.

[c]If mortgage redeemed within 5 years, a charge of 1% of the capital is levied.

[d]Charge, not exceeding equivalent of 6 months interest may be levied.

*Figures in this column assume that no cash sum is taken.

**Annuity payable monthly in advance, guaranteed 5 years. Based on purchase price of 10,000.

the eligibility for and amount of benefits receivable by elderly homeowners from income-conditioned programs is an important issue.

Given a limited perspective, HAP may be viewed as an alternative to or replacement for the current property tax concessions (exemption, credit, or deferment programs) in a number of states. Broadly speaking, because of its implications for all assistance programs aimed primarily at the aged, HAP would have an impact on social welfare programs to provide public assistance, social services, and protective services at all levels of government. What incentive is there for the elderly homeowners to use HAP if it reduces government transfer payments otherwise available to them?

In terms of its linkage to income-conditioned programs, HAP income may be treated in three different ways. First, HAP income is included as countable income, so the receipt of housing annuity will offset dollar for dollar any income from social welfare programs. This method appears objectionable in that there is no incentive for the homeowners to spend down their asset in the form of home equity. Second, HAP income is not counted as income in establishing eligibility for or benefit amounts from social welfare programs. This method seems unsatisfactory because, with HAP income added, some recipients of welfare payments, cash or in kind, will be better off than other recipients. Third, HAP is counted as income, but it will not reduce payments from welfare programs on a dollar for dollar basis. This method holds promise, as it recognizes both incentive and equity considerations. Under it, the offset could be of two types: a uniform offset that reduces welfare payment 10¢, 15¢, or 20¢ for every dollar from HAP; or a sliding-scale offset that reduces welfare payment 10¢, 15¢, or 20¢ depending upon the level of HAP income received. The

uniform offset formula in effect establishes a uniform marginal tax rate, while the sliding-scale formula produces a graduated, progressive tax rate structure.

A combination of the three methods may produce a workable procedure. Instead of totally including or excluding HAP income, an exemption level could be established. If a welfare recipient's HAP income exceeds the exempted amount, then his or her welfare payment will be reduced, on a sliding-scale, by 10, 15, or 20% according to the amount of HAP income over the exemption. This procedure is similar to the earnings test under the Social Security program, except in the HAP income test proposed here a sliding-scale offset is provided.

Under such a formula, receipt of HAP income will reduce the welfare payment if the HAP income is above the exempted level, but the welfare recipient will always enjoy an addition to his or her total income (welfare income plus HAP incomes) when HAP is utilized. An incentive exists, therefore, for welfare recipients to convert home equity into current income.

The suggested method of treating HAP income raises an issue with respect to the regular annuity income. Since regular annuities are included in countable income, housing annuities, when treated as suggested, are given preferential treatment. This may be the basis of an objection to the formula suggested.

However, at present (since October 1976), house value no longer serves as a condition on eligibility for the Supplemental Security Income program (SSI). In other words, homeownership completely eludes the counting of resources. If this policy is continued in the future when HAP becomes available, housing annuities would be totally exempted. But how likely is the present policy of ignoring house value to be continued? It may be

argued that the present policy is adopted in the era without HAP and will be changed when HAP is available.

Should HAP become a reality, housing annuities would be properly regarded as part of the total resources in establishing eligibility and/or benefit levels under SSI. In this context, the formula we proposed above for treating housing annuities reflects the view that homeownership should count as part of total resources when current income could be generated from it, but HAP income should not so reduce SSI income as to provide disincentives for welfare recipients to dissave or spend-down their home equities.

5. CONCLUDING REMARKS

These major questions have been dealt with in this paper: (1) how to assess the importance of net worth in measuring the economic welfare of individuals, especially the aged; (2) how to transform a stock of wealth or capital into a flow of income; And (3) how to treat the income that is generated out of assets from the standpoint of eligibility requirements and benefit levels under income-conditioned welfare programs.

Our findings are as follows: (1) The importance of net worth in terms of its contribution to the current income increases with age, with the greatest contribution to the economic welfare among the aged. (2) For the elderly, the housing asset is often their single most important item of wealth. It is necessary to create a new financial instrument in order to assist the aged to liquify their stock of wealth in home equity into a flow of currently spendable cash. The instrument suggested is a Housing-Annuity

Plan. (3) In determining eligibility for and benefits receivable by aged homeowners from income-conditioned welfare programs, we suggest a formula which provides an exception for housing-annuities up to a certain level and which reduces welfare payments, on a sliding-scale, when housing-annuities exceed the exempted amount.

NOTES

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[1]The theoretical measure of combining potential income from net worth with current money income has been advocated or approved in the literature. See, for example, Chen (1966, esp. pp. 42-44); Weisbrod and Hansen (1968).

[2]Estimates for 1962 are based on the Federal Reserve survey (1966). Estimates for 1971 are based on a University of Michigan Survey Research Center study (1976).

[3]See note 2.

[4]Based on the Federal Reserve survey (1966).

[5]See note 4.

[6]See note 4.

[7]See footnote 4. An appendix on the complex procedures for estimating the alternative income measures 2 through 5 is available on request from the author.

[8]The mechanics as well as the rationale of such a plan were specified earlier in Chen (1967).

[9]The reasonable degree of appreciation and depreciation would have been taken into account in computing the size of annuity at the start of the contract, since the mathematical formula for the computation contains these factors.

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The Treatment of Wealth in Means-Tested Transfer Programs

Michael K. Taussig

Governments provide cash and in-kind transfers to support a minimum level of consumption for people unable to support themselves. These transfers are income-conditioned or, more generally, means-tested to insure that benefits go in the right amounts to the right people. That is, a means test is supposed to deny benefits to people with means sufficient for self-support and it is also supposed to insure that benefits are smaller for the relatively less needy than for those utterly destitute. If the means test is to function properly, it is obviously crucial that "means" be defined operationally as the best possible approximation to a comprehensive measure of economic well-offness. If means for the means test are not appropriately defined and measured, the benefits from government programs will be distributed inequitably in both horizontal and vertical aspects: Equally well-off persons will receive unequal benefits and a better-off person may receive larger benefits than someone worse off. In addition, an imperfect measure of means will create undesirable incentives for some people to alter the composition or the timing of their transactions in order to maximize their well-offness. For any public finance scholar, these points are self-evident and familiar in their application to the need for a comprehensive income or consumption base for personal taxation. Indeed, the personal taxation literature is directly relevant to the subject of this paper and will serve as the basis for much of the following analysis.

Consider a simplified description of a means-tested program paying benefits in the amount B, as determined by a maximum benefit amount G

and by an explicit or implicit tax rate t applied to a measure of means, Y:

$$B = G - tY.$$

The measure of means Y includes earnings E and an amount R, equal to some fraction, α, of net assets W:

$$Y = E + R.$$

$$R = \alpha W.$$

Benefits under such a means test could be written as:

$$B = G - t(E + \alpha W).$$

The value of α and the amount R included in the measure of means would depend on the rate of return to wealth and, possibly, also on some additional wealth-utilization requirement.

The above description does not fit the typical means-tested program in the United States today. The value of α for the means test depends critically on the fraction m of the returns to wealth in monetary form. Also, the typical means test applies a 100% statutory tax rate to most unearned income in monetary form and some include a side condition that eligibility for receiving payments under the program depends on countable assets not amounting to more than a specified asset limit of X. Thus, the benefits under a typical means test may be approximated as

$$B = G - tE - mR \text{ for } W < X.$$

$$B = 0 \qquad \text{for } W \geq X.$$

The inequity of such treatment of assets in means-tested transfer programs is obvious; the effective tax rate on wealth can be zero, or approach infinity, or take on any intermediate value. Any proposal for a similar treatment of assets in the personal income tax would be unacceptable. Yet

there seems to be no difference in principle between personal taxation and means-tested transfers with respect to the appropriate treatment of assets as part of the means available for personal support.

Duskin (1976) has outlined broad policy options for the treatment of assets in determining means for income-conditioned programs. First, the present treatment, as outlined, could be retained. Second, the full returns to assets could be included in Y instead of just the monetary returns; that is, the value of R could be increased to include the full returns to wealth by including nonmonetary returns in Y--especially unrealized capital gains and the imputed rental income from owner-occupied housing and consumer durables. Third, some fraction of wealth could be assumed to be available for personal support through liquidation or as collateral for borrowing, thus raising the value of R still higher. The effective marginal tax rate on R could, of course, be reduced below 100% in either of the latter two alternatives. These options, with some variations, would seem to cover the main alternatives available to society; they all involve a judgement about the degree to which wealth should contribute to the presumed means of an individual or family and they can all be summarized in terms of the value of a single parameter, α. A choice among the options involves consideration of matters of fact, economic theory, and social values.

This paper approaches its subject according to the following outline. The first section below briefly reviews some relevant evidence on income and wealth distributions. A second section outlines the treatment of assets in a simple normative model that constructs a unified tax-transfer program for a world in which assets are accumulated only by personal

saving in order to provide an optimal life-cycle pattern of consumption. A third section uses this normative model to assess the equity problems involved in including some portion of wealth in the measure of means for a means-tested transfer program. A fourth section discusses the full taxation of income from assets and suggests a possible solution for the problem of imputing income to owner-occupied housing and other assets yielding nonmonetary returns. A fifth, final section summarizes the paper and presents some personal conclusions.

1. RELEVANT DATA ON INCOME AND WEALTH

The economic status or well-offness of a family or unrelated individual consumer unit in some time period depends both on its income during the period and on its initial wealth. The relative importance of each in determining a unit's means depends on their relative amounts and on the weight, α, that is applied to wealth. What can be said about the quantitative importance of wealth relative to income--given values of α--in determining the well-offness of consumer units in this country? Further, what can be said about the effect of wealth holdings on the distribution of well-offness (as compared to the distribution of earnings or income) among the whole population and among various demographic groups? If total means for means-tested programs included wealth for given values of α, what would happen to the level and distribution of benefits paid by the several government income-conditioned transfer programs relative to benefits paid under the existing treatment of assets? These questions are crucial for this paper, but they cannot be answered with any precision with available data.

Before looking at the actual wealth and income data, consider first some hypothetical numbers for a consumer unit in this country with mean income and mean wealth. National income account data suggest that in any year aggregate earnings, E, might be three times the amount of aggregate property income of all kinds from conventional personal assets. If we assume a (pretax) rate of return to wealth of 10%, the implied annual earnings to wealth ratio is less than one-third. If we were willing to assign a value as high as .30 to α, then, for a consumer unit with mean income and mean wealth, wealth would be roughly as important as annual earnings in determining its well-offness. We know, however, that the distribution of conventional personal wealth holdings is much more highly skewed than the distribution of earnings and therefore suspect that the numerical exercise above has little relevance for most units in the target populations for income-conditioned transfer programs.[1] For the purposes of this paper, it is necessary to go beyond average earnings to wealth ratios and to examine actual data on the covariation of earnings and wealth at the bottom tail of the income distribution. If income-poor people eligible to receive benefits from income-conditioned transfer programs have little or no wealth, then the issue of the treatment of assets in these programs is of little practical importance.

The best available data combining income and wealth of consumer units appear to tell us that wealth is of relatively small but not negligible importance in contributing to the means of low-income families and individuals. These data come from the Survey of Financial Characteristics of Consumers (SFCC), which reported annual money incomes for 1962 of consumer

units and the wealth of these units as of December 31, 1962. The SFCC data are far from ideal; neither income nor wealth was comprehensively defined and the survey results for both were plagued by extensive, non-random underreporting.[2] The data are badly dated and no comparable survey has been conducted since 1962 to provide us with evidence of any changes over time. The SFCC data are, nevertheless, the best available for our purposes.[3]

The relative importance of SFCC wealth in contributing to the means of low-income units can best be seen by looking at the wealth of the units that had annual money incomes in 1962 under $3000. According to the SFCC results, of all these low-income consumer units, 43% had wealth of less than $1000 as of December 31, 1962. Eighteen percent had wealth of between $1000 and $5000 and another 15% had wealth of between $5000 and $10,000 (see Projector and Weiss 1966, Tables A-2, A-5). Thus, according to the SFCC, the great majority of low-income families had little or no conventional personal wealth. On the other hand, a minority of such families had considerable wealth. The mean wealth of this low-income population was $7069, more than 40% of it in the form of equity in owner-occupied houses.

The age pattern of wealth holdings by low-income families in the SFCC is also noteworthy. Of consumer units with annual money incomes in 1962 under $3000 and headed by someone aged 65 or over, 26% had wealth of less than $1000; 16% had wealth of between $1000 and $5000; and another 24% had wealth of between $5000 and $10,000. More than one-third of these aged, low-income families had wealth of more than $10,000, or more than three times their annual incomes. The mean wealth of the aged, low-income group was $9702. In general, the SFCC results show that the aged had

significantly higher wealth to income ratios than the general population, even at very low income levels.

A special SFCC study looked specifically at the assets of the units officially poor in 1962 by the Social Security Administration definition. Most of the SFCC units officially poor according to their annual incomes and their nonincome characteristics had little or no assets. But 12% of the units poor according to income had wealth of between $10,000 and $25,000 and another 6% had wealth of $25,000 or more. Poor (low-income) units headed by an aged person had more wealth on average than other poor units. The study further found that, under the assumptions that poor units used up their liquid and investment assets over a period of five years or more and enjoyed an imputed income from owner-occupied houses equal to 4% on their equities, 13% of them would not be poor by the official poverty definition (Projector and Weiss 1966, pp. 37-41). The authors of the study gave no justification for their implied value of α in weighting wealth and it must be considered wholly arbitrary. Thus, the SFCC results seem to tell us that most units with low incomes have little wealth but that a nonnegligible minority of some units, particularly aged units, have considerable wealth. The SFCC provides very little information, unfortunately, about the quantitative dimensions of the contribution of wealth to the means of these low-income units. It is also important to add that, because of severe underreporting of asset values, the importance of wealth in the SFCC data must be an underestimate.

Social Security Administration survey data provide us with some additional information on the role of wealth in determining the means available to the aged. Murray (1964) used such data from the 1963 Survey

of the Aged to construct the "potential income" of aged units and to compare the estimate of potential income with actual income. Potential income was estimated by applying a value of α to the reported assets of units in the Survey determined by assuming that the current value of such wealth was equal to the amount of a life annuity at a 4% rate of interest.[4] Murray reported that median potential income was about 30% greater than actual income for the units in the study. About two-thirds of the difference was accounted for by the value of equity in owner-occupied houses. The difference between actual and potential incomes was markedly less, however, for very low-income aged units. A more recent Social Security Administration survey study of assets of the aged by Sherman (1976) found similar results: most low-income aged units reported few assets and equity in a unit's own house dominated more liquid assets in value. The general impression from both of these studies is that the great majority of aged, low-income families and individuals have little wealth to use to finance their consumption. Unfortunately, the quality of the wealth data in these survey studies was so poor and so biased toward underreporting of actual total asset values that it is not clear that they give us any additional useful information on the contribution of wealth to the total means of low-income aged units than the SFCC. The wealth in these surveys certainly does not add up to anything close in value to the wealth reported in national balance sheet estimates for households.

To summarize briefly, available data make it clear that wealth has an important effect on the means of many consumer units for some plausible values of α. If total means are taken to include wealth at some value of α, then the distribution of means is quite different from the distribution of annual income or earnings. In particular, the

aged have relatively more means when wealth is taken into account, provided we accept the conventional definition of personal wealth. Many low-income units have little or no wealth. The means of some low-income consumer units, however, particularly aged units, are understated by their incomes, but the available data give us only a minimum estimate of the degree of this understatement. The evidence is weak but it does suggest that the contribution of wealth to means cannot be neglected in designing income-conditioned (means-tested) transfer programs.

2. THE TREATMENT OF ASSETS IN A LIFETIME ACCOUNTING PERIOD

This section discusses the treatment of assets in means-tested programs in an intentionally abstract setting. The purpose of the discussion is to clarify the issues concerning the treatment of wealth in a means test. The setting for the analysis is a world in which personal saving is done solely for the purpose of financing future consumption in a life cycle in which income varies much more over time than does desired consumption. Fully rational individuals in this world of certainty foresee that their consumption needs will exceed their retirement incomes and thus they accumulate wealth in order to finance their retirement. (Or at least they would always do so in the absence of a transfer program to support their retirement.) Capital markets are perfect and all individuals can borrow and lend at the going market interest rate r. When people retire, they can always buy life annuities yielding a guaranteed annual cash flow for the rest of their lives. What can we say about the optimal tax and means-tested transfer systems in such an idealized world?

In his classic treatise written some three decades ago, Vickrey (1947) gave an answer to this question for the tax system in his proposal for comprehensive lifetime income averaging. The essential point of his scheme is that a person's whole lifetime is taken as the appropriate accounting period for determining tax liabilities. Vickrey conceived of equity in a lifetime, rather than in an annual accounting period and also analyzed the tradeoff between equity and efficiency within a long-term rather than a short-term context. The recent revival of interest in a consumption rather than an income base for personal taxation is also motivated in part by the equity and efficiency arguments for levying personal taxes within a long-run accounting framework. The logic of this work on personal taxes can be applied directly to the design of an equitable mechanism for providing means-tested transfers.

The lifetime accounting period approach could be used to design a combined tax-transfer system along the following lines: Let the tax base be individual consumption expenditures C in excess of an exemption level X, or C - X. For simplicity, abstract from the tax unit problem and let all taxation be on an individual basis. Tax liability in time period T would be a constant proportion t of taxable consumption, or $t(C_T - X)$, for $C_T > X$. Transfer payments would be determined in the same way, or $t(X - C_T)$ for $C_T < X$. The constant tax rate t and the symmetry of the tax and transfer computation solves immediately a number of problems associated with a progressive rate structure while leaving the whole system progressive with respect to the consumption (C) base. This aspect of the scheme is not essential, however; Vickrey and others have worked with a progressive rate structure combined with mechanisms for averaging over time. The

system is strictly neutral with respect to saving and wealth accumulation. If an individual saves an amount S, his tax liability in this period is reduced by an amount tS. But since all saving is for future consumption, his consumption η periods in the future will be higher by an amount $S(1+r)^{\eta}$. The present value of the incremental future tax liability is given by $\frac{tS(1+r)^{\eta}}{(1+r)^{\eta}}$, or tS. In other words, in this simple world, the present value of taxes depends only on the level of the present value of lifetime consumption, and not on its distribution over time. Provided that X and t are chosen at appropriate values, this system of taxes and transfers will provide a considerable degree of redistribution of consumption from the (lifetime) rich to the (lifetime) poor.

For the purposes of this paper, the important point is that this kind of combined tax-transfer system provides the appropriate means test for taxes and transfers alike <u>without any explicit consideration of personal wealth</u>. By assumption, wealth in this world is accumulated only for the purpose of future consumption. All wealth is liquidated at the individual's death and it is taxed as it is decumulated and spent on consumption. The model can readily be extended to accomodate wealth accumulated by inheritance and <u>inter vivos</u> transfers. Such inflows of funds could be taxed as they are decumulated and spent, just as wealth accumulated by saving out of earned income. Since every individual faces the same marginal tax rate t, the transfer of wealth between any two individuals will not affect the present value of total personal tax liabilities. As noted above, with perfect capital markets, the postponement of taxation

because of wealth transfers or any other reason has no effect on the present value of total tax liabilities. There can, of course, be special additional taxes on wealth transfers, just as there are in the existing tax system.

To illustrate how this scheme would work, consider a two-period lifetime and two individuals, A and B, holding no initial wealth and with equal earnings E in period 1 who retire at the beginning of period 2. Individual A purchases a house for cash in the amount S in period 1 and has no other savings. Individual B consumes all his income in period 1 and has no means of support in period 2. Individual B will pay tax $t(E - X)$ in period 1 and receive a transfer of tX in period 2; the present value of his lifetime tax (transfer) is $t[E - X(1 + \frac{1}{1+r})]$. Indivdidual A will be treated exactly the same if his expenditure for the house is considered a consumption expenditure and the return to his saving in period 2 is ignored. Alternatively, his expenditure S on the house in period 1 could be made deductible (as saving) from his tax base in period 1 and the imputed return rS to his investment would be included in his means in period 2. In the latter case, the present value of his lifetime tax (transfer) is $t(E - X - S) + \frac{t(S(1+r) - X)}{1+r}$ or $t[E - X(1 + \frac{1}{1+r})]$. In either case, lifetime tax liability is unaffected by saving and wealth accumulation. The appropriate measure of means for the means test is annual consumption expenditures, calculated as the excess of all personal cash receipts (net of the expenses of earning income) over funds invested in assets.[5] Since such a measure of means would be based entirely on market transactions, it has administrative as well as equity and

efficiency advantages over alternatives such as income or income plus wealth.

The simple normative model sketched out above suggests the appropriate value for the parameter α in determining means for a means-tested transfer program. The value of α should be determined by the proportion of wealth actually dissaved and used to finance consumption during the relevant accounting period. The means test need not involve any specific taxation of wealth or the returns to wealth in determining the level of benefits. Persons with low earnings and large wealth holdings may receive welfare benefits under this system if they do not dissave sufficiently, but this will not increase (decrease) the present value of total net transfer benefits (taxes).

This strong conclusion is based on a very simple model. The model is certainly overly abstract for direct application to social welfare policy, but it does seem helpful in clarifying the reasons why society may wish to take wealth explicitly into account in measuring means for a means-tested transfer program. The model is based on several strong assumptions and it is reasonable to ask how sensitive the basic conclusion may be to relaxing each assumption. First, the tax transfer system in this country is not based on a consistent income or consumption definition, is not coordinated and strictly proportional for positive and negative net income (or consumption), and is full of loopholes and imperfections. Second, capital markets are imperfect; rates of return to saving vary greatly and are often below the rate of interest at which individuals can borrow. Some economists would even argue that variation in wealth accumulation for individuals of equal

endowments and identical earned income streams is mainly a function of random variation in rates of return rather than differences in savings rates. The extreme version of this argument holds that all returns to wealth are pure windfalls unrelated to objective differences in the riskiness of personal investments.*

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*Editor's note. The following comment, which is relevant at this point, was offered by William A. Klein at the Conference.

> Let me offer an intuitive, heuristic, and discursive approach to the variation in amounts of wealth that people have.
>
> To begin, suppose that an individual during his working years has an income comfortably above the poverty level, and suppose that that person pays an income tax and saves aftertax earnings toward retirement. Those savings are tax paid and should attract no further income tax when they are used for consumption. At the same time, if those savings are sufficient to meet needs, most of us would agree that there should be no welfare payments. It is just a matter of timing of consumption. Let us take a look at various alternatives for producing the no-welfare-payment result. (1) We can somehow include the asset in the need calculation for welfare benefit purposes. (2) We could pay welfare benefits and put a lien on the savings. And (3) we could adopt a lifetime accounting system with a notion that one ought to save for retirement to the extent that one is able to do so.
>
> Next, that's all well and good, but what about a person with the same earnings who has not saved anything. The prodigal. Not the person who has had bad luck. Here we are stuck. We cannot let the person starve; we must pay some benefits and therefore accept some inequality between this person and the saver. But we may be justified in treating the prodigal person harshly, reflecting our ethical judgment that a person has an obligation to save against rainy days, if financially able to do so.
>
> We might have a different attitude entirely toward a person whose failure to provide against the rainy day is involuntary--toward the person whose income was never high enough to allow saving. Then what about the person whose income was just at the poverty level but who, nonetheless, miraculously, did save? For such a person we might be willing to ignore assets in determining availability of welfare benefits. That may explain our sympathy toward the welfare family that tries to save its way out of poverty.
>
> Note the importance of a long-term perspective. By failing to take a sufficiently long-term perspective, we fail adequately to distinguish among people according to their wealth.

Third, individuals may save and accumulate for the sake of accumulation itself, not for future consumption. The normative model in this section assumes that wealth accumulation is only a means toward the ultimate end of future consumption and is not important in itself. If, however, individuals derive utility directly from the holding of wealth, the major behavioral premise of the model falls. The available evidence provides at best a weak empirical foundation for the simple version of the life-cycle model of consumption and saving behavior.[6] If wealth is accumulated for its own sake, there is a prima facie equity case for inclusion of at least some portion of wealth in the measure of means for tax and transfer purposes. In addition, society may wish to impose special taxes on wealth because it objects to what it judges to be excessive personal wealth accumulation. It is possible that, after taking into account all the above possibilities and perhaps some others, a revised, more complex normative model would call for placing a larger value on the parameter in determining means for a means test and for explicit taxation of wealth.

Space limitations and lack of sufficient empirical evidence preclude an adequate discussion of all these issues. Instead, I will simply assert a tentative personal conclusion that none of the points raised above is a fatal objection to a personal consumption basis for the measure of means for means-tested transfers. In particular, imperfections in the tax system and in capital markets do not make a strong equity case for

alternatives to consumption as the appropriate measure of means. At worst, a more complex normative model would only weaken the equity case for a personal consumption measure of means. The compelling efficiency (neutrality) and administrative arguments for a consumption measure of means would remain unshaken. Furthermore, the main equity argument against a consumption measure of means for a means-tested transfer program seems to be that recipients of transfers may hold on to their wealth for their heirs at the expense of taxpayers unless they are required to dissave to support themselves. If this really is a problem, it can be dealt with by a special tax on the bequests and gifts of the beneficiaries of means-tested transfer programs; that is, such wealth transfers could be treated as "consumption" under the rules for means-tested transfer programs.

A final, very important point to be made in this discussion is to note that society appears unwilling to accept the ethical basis of the normative life-cycle model. That is, society does not accept the ethical proposition that individual A and individual B are equally well off if they enjoy equal lifetime consumption. If, say, A and B have equal endowments and lifetime earnings and are alike in all relevant respects, but A chooses to consume all his earnings prior to retirement while B chooses to save and accumulate wealth, our normative model says that, at retirement, equity calls for ignoring B's assets in calculating his means-tested transfer payment except as they are actually disposed of and used to finance his consumption. Society does not accept the basic premise of this argument. The prevailing view seems to be that bygones are bygones and that the past is irrelevant in determining the present relative status of the two

individuals. Considerations such as imperfect capital markets, uncertainty and chance and irrationality all are relevant to the prevailing ethical view.

Society rejects the ethical basis of the normative life-cycle model and therefore insists that wealth be incorporated into a means test for means-tested transfer programs. In the previous paragraph's example, society insists on including A's assets in his means as if they were fortunate accidents that had happened to him rather than the results of his own decisions. B's lack of assets is correspondingly regarded as an unfortunate accident. In short, society rejects the lifetime accounting period and chooses to treat each year or even each month as the appropriate period for providing means-tested transfers to the poor. This point is basic to designing the appropriate inclusion of wealth into a means test for transfer programs.

3. INCLUSION OF A PORTION OF WEALTH IN MEANS

Wealth may be taken into account in a measure of means for a means-tested transfer program in two distinct ways. First, some fraction of wealth may simply be added to income not derived from wealth while actual income from assets is ignored. If this approach is adopted, some method of determining the appropriate fraction of wealth to be included in means must be devised. Second, actual income from wealth may be included in means while the amount of wealth and the potential income from wealth are ignored. This section takes up the first approach; the next section will treat the actual income from wealth alternative.

The case for including some portion of wealth in means is based on the notion that assets provide potential resources for the support of a consumer unit in addition to its actual income from other sources. These potential resources from wealth will generally not be measured accurately by the actual income derived from wealth in any period. Thus, two individuals A and B with the same income in some year are not equally well off if A has positive wealth and B has zero wealth. Individual A could finance more personal consumption than B by disposing of some of his assets or by using them as collateral to borrow. The normative life-cycle model outlined in the previous section would take this circumstance into account to the extent that A actually did dispose of his assets or did borrow to finance additional consumption. What may be called the potential income approach instead assigns some value to the fraction of A's wealth that he might reasonably be expected to use to finance his consumption. In the limit, this approach could include A's entire net wealth in his potential resources in any time period.

Economists who have adopted the potential income approach to the measurement of economic well-offness have stopped far short of this extreme position. Instead they have adopted one of two approaches to determining the fraction of wealth to be included in potential income: the life annuity method or inclusion of some arbitrary percentage of wealth. Writers who have used some variant of the life annuity approach include Moon (1975), Murray (1964), Taussig (1973), and Weisbrod and Hansen (1968). They all assumed that potential income should include a fraction of wealth determined by the annual life annuity value of that wealth. According to this assumption, all personal wealth has an annual

potential income value in the current period equal to the level annual life annuity amount that the amount of the person's net wealth could be exchanged for at some assumed rate of interest. The value of the life annuity amount varies directly with the rate of interest and inversely with life expectancy (directly with the individual's age, ceteris paribus).[7] For example, at an interest rate of 6%, the life annuity value of $10,000 of net wealth is about $1130 per year for an individual with a life expectancy of 13 years (the approximate value for a white male in the United States aged 65) and only $782 per year for an individual with a life expectancy of 25 years (the approximate value for a white male in the United States aged 48). At an interest rate of 8%, the corresponding life annuity values are $1265 and $937. It is immediately apparent that the life annuity method implicitly assumes that an older person's wealth contributes more to his or her potential income than does the same amount of wealth for a younger person. Older people are better off, other things equal, because they have fewer expected years of life remaining over which to spend a given amount of wealth.

An alternative to the life annuity method that avoids this paradoxical result is to assign an arbitrary percentage of wealth, equal for individuals of all ages, to be included in potential income. This method was used by Projector and Weiss (1966) and discussed by Klein (1974). Projector and Weiss, for example, investigated the extent to which consumer units were raised from below, to, or above the poverty line when their liquid and investment assets were assumed to be used up in 5 years or more to supplement their money incomes and an imputed return to home equities (Projector and Weiss 1966, pp 37-41). Klein appeared to look favorably on

the inclusion of 10% of wealth in the countable income for a negative income tax as an alternative preferable to the life annuitization of wealth (Klein 1974, p. 465). The value of 10% or any other value is arbitrary but this method avoids penalizing the aged for having low life expectancies in actuarial tables.

The case for including some fraction of wealth in potential income and, by extension, in the measure of means for a means-tested transfer program, may appear to be straightforward. The argument is that personal well-offness is better measured by potential income or resources than by actual income. Given the level of income, ownership of wealth increases the potential resources for an individual and thus it is arguable that, to achieve equity, this circumstance should be reflected in a means test. It is true, of course, that counting some fraction of wealth in means will create more or less serious perverse incentives for individuals to spend or give away their assets. It is also surely the case that it will create formidable enforcement problems for the administrators of means-tested programs in tracing the ownership of assets and in ascertaining the value of these assets once they are located.[8] These are, however, the familiar tradeoff problems that currently exist with the personal tax system and society will presumably accept some allocative and administrative costs to achieve greater equity in means-tested programs. The choice of the method for determining the precise fraction of wealth to include in means is a troublesome problem; the two methods outlined above do not exhaust all the possibilities, but this is perhaps a minor matter for which there could be found a satisfactory solution.

The arguments summarized above have some plausibility but upon careful analysis they do not add up to a strong case. First, the point of the normative life-cycle model discussed in the previous section is that the equity argument for inclusion of wealth in the measure of means for a means-tested program is weak, except perhaps for wealth that is inherited or acquired by windfall. I find it hard to believe, on the basis of the little evidence available, that the target populations for means-tested transfer programs hold significant amounts of inherited wealth. Second, the argument for including a portion of wealth in the measure of means assumes that it is administratively feasible to value assets accurately enough for the means test and that potential beneficiaries of the programs can actually liquidate the assets or use them as acceptable collateral for borrowing at their estimated values in order to finance their consumption. For several kinds of illiquid assets, this assumption is questionable. Third, as observed in the introduction to the paper, inclusion of a portion of wealth in the measure of means for a means-tested program is unfair and overly rigorous by the standards of personal taxation in this country. The personal tax system leaves accumulated assets untaxed while held by the original owner. Estate, inheritance, and gift taxes apply to assets only when they are transferred to new owners and, even then, effective tax rates on quite substantial wealth transfers are generally low because of large exemptions and because of features of the tax law that invite tax avoidance. I see no compelling equity argument for any asymmetry between the tax and transfer systems with respect to inclusion of wealth in the measure of means.

In addition to the foregoing arguments, it is important to observe that the conventional definition of wealth will not do for an equitable

means test. For some purposes, the conventional definition of personal wealth as the market value of the rights to the use of private assets such as structures, capital equipment, durable goods, and a large variety of paper assets is quite useful. It is clear from a reading of the academic literature and the statutes on income-tested transfer programs that this conventional definition of wealth is generally taken to be appropriate for a means test. However, if the purpose of a means test is to ascertain the consumer unit's potential income or means, the conventional definition of wealth is inappropriate, and a much broader concept is required. The most obvious shortcoming of conventional wealth for use in a means test is that it excludes the enormous value of human capital. Kendrick (1974) has recently had the courage to estimate the value of human wealth in the United States and has reported that it slightly exceeds the value of nonhuman wealth. To include the actual return to human wealth, earnings, and the actual return to nonhuman wealth, property income, in any year for a means test has the merit of consistency.[9]

Alternatively, it may make sense to attempt to estimate the potential returns to both human and nonhuman wealth in a means test, perhaps by capitalizing all potential future incomes and converting the means test into a broadly defined wealth, or lifetime potential income test. It is inconsistent, however, to mix actual earnings and potential income from assets (by including some portion of wealth in the measure of means). To do so clearly discriminates against those consumer units that have relatively low earnings potential and relatively large holdings of conventional assets--the aged, in general.[10] Indeed, it seems to me that including only

conventional wealth in the measure of means for a means test is essentially a device for transferring welfare benefits from the aged to the nonaged.

Another major category of wealth besides human capital is excluded from the conventional definition of wealth, making it even more inappropriate for use in a means test. This category of wealth is the present value of contingent rights to pensions and other benefits. These benefits include rights to cash incomes and in-kind benefits payable in case of death, disability or retirement of workers covered by the federal Social Security programs or by related private or public employer plans. The aggregate amount of such wealth is enormous under reasonable assumptions. Feldstein (1974) has estimated that in 1971 the amount of wealth in the form of contingent claims to Social Security retirement benefits alone net of the present value of future Social Security taxes amounted to 30% of the value of conventional private wealth held by those in the labor force. This estimate did not include the additional considerable wealth in the form of contingent claims to other Social Security and private and public employer benefits. For example, the present value of survivors, benefits for the widow and three or more surviving young children of a young worker with median or below median earnings can amount to more than $100,000 at plausible rates of interest. Few would argue that some portion of this contingent wealth should be included in the means test for SSI for the disabled in the case of a family with a disabled male worker with a short life expectancy. The huge amount of wealth of this kind cannot be ignored in any equitable means test including a portion of conventional wealth in the measure of means.

To summarize this section briefly, I judge the case for inclusion of a portion of wealth in a means test to be very weak on several grounds.

Perhaps the most basic objection is that the conventional definition of wealth for a means test includes considerably less than one-half of all wealth in the United States, if wealth is comprehensively defined. Since it is beyond human capacity to measure a comprehensive definition of wealth for all consumer units, it is inequitable to include only the fraction of total wealth that can readily be measured as conventional wealth in a measure of means. To do so discriminates sharply against some needy individuals in the target populations for means-tested transfer programs, notably the aged and others permanently out of the labor force.

4. THE TREATMENT OF INCOME FROM ASSETS

If the argument of the previous section is accepted, and no portion of assets is to be included in the measure of means for a means test, what then is the appropriate treatment of the full income return from assets? Probably most economists would accept the view that all net income from assets should be included along with all income from other sources in a comprehensive income measure of means. If all earnings are included in means, then it is hard to justify not including all unearned income as well. The case for full inclusion of income from assets in the measure of means for a means-tested transfer program is not, however, all one-sided. Appeal once again to symmetrical treatment with the personal income tax suggests noninclusion of some returns to capital: unrealized capital gains and imputed income to assets such as owner-occupied houses and consumer durables. It is not easy to justify continued toleration of loopholes--if that is what such exclusions are--in the personal income tax with the rigorous closing of such loopholes in

means-tested transfer programs. The more fundamental point against full inclusion of unearned income in the measure of means is, as argued previously, that a lifetime concept of equity calls for the exclusion of such income on the grounds that it has already been taxed once to the extent that the assets were acquired by saving out of income. However, this conclusion is derived from the assumption of the desirability of a personal consumption base for taxation that is not widely accepted. The discussion below will proceed therefore on the assumption that equity in a means test calls for inclusion of the full income from all net assets of a consumer unit.

The money income return to assets is everywhere included in the measure of means for income-conditioned transfer but, as noted earlier, two important types of nonmonetary returns are excluded: unrealized capital gains and the imputed income from owner-occupied houses and consumer durables. Imputed, in-kind, and unrealized capital gains income are important components of the returns to certain assets; in the absence of such nonmonetary income, the returns to many investments would typically be negative. Nonmonetary returns are particularly important for owner-occupied housing and some consumer durables, which are prominent assets in the total wealth of many potential recipients of income-conditioned transfer programs. Any means test that includes monetary returns but excludes nonmonetary returns to assets is manifestly unfair and creates undesirable incentives to channel personal investments into assets that yield all or most of their returns in nonmonetary form. In principle, then, nonmonetary returns should be placed on an equal footing with monetary returns in any means test. However, implementation of this principle involves its own serious equity and administrative problems.

For specificity, the following discussion concentrates on owner-occupied housing but it applies as well to a wider class of assets. Many low-income consumer units, especially the aged, live in housing that has a high value relative to the current annual income of the unit. In some cases, the market value of the house is appreciating over time, especially if inflation is ignored. The total return to the property includes its imputed rental income plus any unrealized capital gains during the current period. If the money returns to liquid assets are included in an income test, then equity calls for including the total nonmonetary return to the house as well. If this were to be done, however, it would necessarily involve administrators in ascertaining the market value of the property <u>every year</u> without the aid of market transactions. This task would at least place great strain on the resources of administrators and very likely would be beyond their capabilities. Beneficiaries of the transfer program would suffer, of course, if administrators overestimated either the level or the change in the value of the property. Even if the property assessments were exactly correct, beneficiaries would suffer to the extent that they were "overconsuming" housing.[11] The available wealth-income data appear to show that this is a common situation for many low-income consumer units whose incomes have fallen from previously higher levels. The issue raised by this circumstance is whether the principle of equity in a means-tested transfer program is important enough to force many low-income persons to choose between a sacrifice of cash benefits for support of consumption needs other than housing or to dispose of a house (or other property) that may have been owned by the family for several decades.

The issue could be largely resolved, however, without the need for choosing between two such undesirable outcomes. The principle of taxation of nonmonetary returns could be upheld without actual current cash settlement of the "tax" under a means test. The tax could be assessed as a kind of trial or estimated tax each year, but its actual payment could be postponed until the property is transferred by sale, gift, or bequest. For example, a consumer unit could be paid its benefits under an income-conditioned program as determined only by its current money income. This payment would exceed its actual net benefit by the amount of the implicit tax (benefit reduction) on the nonmonetary returns to the unit's equity in its own house and, possibly, on other assets. This uncollected tax would be estimated roughly in each period and accumulated with interest until the property is transferred. When the property transfer occurs, generally through a market transaction, the estimated accumulated tax would be adjusted to a final tax by taking account of actual market or estimated value, and would be collected by the government as a first lien against the property. This procedure is most directly relevant and best suited to the circumstances of low-income aged units living in owner-occupied housing of relatively high value. For young beneficiaries, it might be necessary to require disposal of the properties or settlement of the amount due after, say, some five or ten years. Payment of the amount due would be expected, if the unit's income rose above the break-even level of income for the program for some extended period of time. Whatever the exact details of this scheme, it has promise for achieving much more equity than present treatment of nonmonetary income of assets in income-conditioned transfer programs, without imposing great hardships on beneficiaries. It is equitable treatment of such assets in a means test,

however, only under the assumption that current annual income is an appropriate measure of means. If, instead, consumption as determined by the cash flow method of accounting were taken as the appropriate measure of means, the problem discussed above would never arise.

5. SUMMARY AND CONCLUSIONS

This paper has discussed the normative issues involved in the treatment of assets in means-tested transfer programs. A review of the sparse data sets available with joint observations on the income and wealth of consumer units reveals that a small, but not negligible, minority of low-income units has substantial wealth. Also, aged low-income units are more likely to have substantial wealth than younger units. The biases in the available data are serious enough to leave open the possibility that wealth holdings by low-income units are much greater than the numbers indicate. These empirical relationships lead to the question of how wealth should be treated in the measurement of means for means-tested transfer programs. The paper has attempted to answer this question by developing a very simple normative model based on a lifetime accounting period. The basic conclusion from this model is that equity could be achieved in a lifetime framework by making annual personal consumption expenditures the measure of means for an integrated personal tax and transfer system. An annual consumption base for taxes and transfers would also have minimal effects on incentives for personal saving and would offer important administrative advantages as well. A consumption-based

tax and transfer system with a proportional tax rate and high personal exemptions could achieve a substantial amount of progressive redistribution of (lifetime) income. Such a system need not and should not directly take account of wealth in the measure of means.

This model is, of course, much too simple to be used directly for the design of social welfare policy, but it does have important negative implications. The most important point is that the equity argument for including a portion of wealth in the measure of means is very weak within a long-term accounting period. Consumer units with low incomes and substantial assets are better off than other units of the same age and with the same incomes either because they were willing and able to save more out of earlier years' incomes or because they refrained from spending out of wealth acquired by inheritance or windfalls. Since the latter possibility seems remote for all but a small minority of low-income units potentially eligible for means-tested transfers, a policy of including a portion of wealth in the measure of means amounts to penalizing successful savers. In a lifetime accounting framework, such a policy is myopic and inequitable; it certainly is not neutral with respect to saving incentives; and it generally has the effect of transferring means-tested benefits from aged to younger consumer units within the same transfer program. As an alternative, a measure of means based on actual consumption expenditures need not concern itself directly with wealth; as wealth is liquidated to finance consumption it will automatically be included in the measure of means and benefits will be adjusted accordingly. Finally, this paper has considered the treatment of the full income returns from assets, including nonmonetary income returns, such as unrealized capital gains

and imputed income from houses and consumer durables. The case for inclusion of the full returns to assets is compelling within a comprehensive annual income measure of means but not within an annual or lifetime consumption-based measure. The equity and administrative problems of incorporating nonmonetary returns to assets in the measure of means for a means-tested transfer program can be largely resolved by not collecting the tax (not reducing the benefits) in cash and by treating it instead as a loan from the government with the asset generating the nonmoney income being the collateral for the loan.

In sum, my personal conclusion is that means tests for means-tested transfer programs should be restricted to a comprehensive measure of annual income or, even better, annual consumption. This conclusion assumes that the primary goal of such programs is the alleviation of permanent or long-term poverty. If the goal is instead short-term emergency relief, then the equity issue is less clear. Perhaps the appropriate policy for a program like AFDC with a temporary relief objective and a very short accounting period is to make loans, rather than outright transfers, to consumer units that suffer sharp, temporary declines in income if they own substantial assets. (Unfortunately, such declines in income may turn into permanent income losses, blurring the distinction between the two objectives of means-tested transfer programs.) But means-tested transfers designed to alleviate long-term poverty should not, in my view, normally incorporate any portion of wealth in their measure of means. The exceptions to this rule should be minor and addressed to the symbolic political issue of paying transfer benefits to persons with very

large wealth. The appropriate means test would provide for a very large exemption of net assets and a tax (benefit reduction) rate well under 100% on the value of assets in excess of the exemption. Exemption levels might reasonably vary with the age of the unit, increasing directly with the age of the individual or the average age of the married couple. Such a measure would amount to no more than a symbolic gesture in response to what is essentially a symbolic problem.

NOTES

[1]This numerical exercise ignores the fact that conventional income distributions include property income and other unearned income as well as earnings. In fact, however, because of underreporting of property income, the income measure for income distributions generally in use comes close to being a distribution of earnings and Social Security benefits. On this point, see Budd (1970, p. 256).

[2]The data are presented and evaluated in Projector and Weiss (1966).

[3]Similar survey data from the Survey of Economic Opportunity for 1966 are far inferior to the SFCC data. Other, similar survey data on wealth are even less useful. Wealth distribution data from estate tax returns cannot be linked directly to a unit's income and suffer from other inadequacies as well. For a survey of the quality and informational content of existing wealth distribution data for the United States, see Taussig (1976).

[4]For a fuller description of the methodology used, see Murray (1964, pp. 3-4).

[5]The details of a "cash flow" method of determining a comprehensive personal consumption base for taxation are carefully worked out in Andrews (1974) and in U.S. Department of the Treasury (1977).

[6]See, for example, Mirer (1977); Shorrocks (1975); Thurow (1975, pp. 129-142); and Ture (1976, pp. 75-81).

[7]The life annuity value a_n of one dollar of net wealth is given by

$$a_n = \frac{r}{1 - (1+r)^{-n}}$$

where n = years of expected life and r is the rate of interest.

[8]These points are discussed in more detail in Duskin (1976).

[9]To be sure, the returns to nonhuman wealth are typically much more "net" of depreciation and other costs than are the returns to human capital. A rough allowance for this difference can readily be provided for in the measure of means for personal taxes and transfers.

[10]This is the thrust of the critique of Weisbrod and Hansen's study (1968) by Projector and Weiss (1969). It is important to add that all income-tested transfer programs in the United States, including SSI for the aged, include consumer units over a wide age spectrum.

[11]For an excellent discussion of this and related points, see Klein (1974, pp. 469-470).

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APPENDIX

A Note: Should Wealth Matter?

Paul L. Menchik

This note focuses on an important conceptual question. Should wealth matter? The answer I give is in the affirmative, and I go on to discuss possible consequences of including consideration of wealth in means-tested programs.[1]

It is important to note at the outset that the asset tests that are currently part of many transfer programs are not appropriate ways to include net worth because they represent arbitrary limits on assets. This creates a notch problem with major inequities between those just below and those just above the limits.

1. THE OBJECTIVE OF TRANSFER PAYMENTS

A major justification for transfer payment programs is that they provide what society deems to be adequate levels of consumption for those whose consumption, in the absence of the payments, would not be adequate. If this justification is accepted, symmetry between the tax and transfer systems no longer follows automatically as a goal. Indeed, the tax system has a very different objective, i.e., to raise a specified amount of revenue consistent with efficiency and equity standards. One equity standard is taxation according to "ability to pay" and another, "equal treatment of equals." There is certainly no unanimous agreement on the appropriate measure of "ability" or what makes people "equals"; and income, consumption, and wealth, or some combination of these are all advanced as possible

candidates.[2] That the present income tax fails to tax the stock, but only the realized return of net worth, does not prove that failure to do so is "optimal" on economic grounds or even politically unacceptable.[3] Martin David (1973), for instance, has argued persuasively for a small net worth tax as an additional federal revenue alternative.

The view that the tax and transfer systems pursue different objectives is manifested in the evolution of negative income tax proposals. As the Lerman paper (5 in this volume) points out, the negative income tax was originally proposed as a simple extension of the personal income tax. However, the recognition that this scheme could not constitute welfare reform led to proposals--including a widening of the income concept--that differed considerably from the original income-tax-based proposal. The question of how assets should be treated in determining the distribution of transfer payments is thus an economic problem, not just a political or symbolic one.

Given the justification at the beginning of this section, the problem can be stated as follows: How should a given amount of resources available for transfer payments be distributed among those who, in the absence of such transfers, would not have what society deems adequate levels of consumption? If transfers are directed to those who otherwise have adequate consumption, the payments, on this logic, have been to some extent, misdirected. Transfer payments allocated among people, consequently, should vary with all resources, both income and net worth, available for their own consumption. If two individuals applying for transfer payments are alike in every respect except net worth, the one with less wealth should be given more since the wealthier individual has a greater amount of resources available for consumption and, therefore, a higher ability to

consume. Thus, if we want to allocate a given amount of transfer payments efficiently—i.e., promote the greatest marginal increase in consumption among those who would otherwise suffer the most deficient levels of consumption--transfer payments should be conditioned upon and vary inversely with all resources, both income and net worth.

This principle is justified on equity grounds as well. As a matter of equity, I think it would be agreed that the wealthier of two otherwise identical people is better off. People derive a flow of benefits, including security or protection against uncertainty, from holding wealth. Individuals purchase insurance policies to protect themselves or their dependents against undesirable contingencies. A person holding wealth insures himself to some extent, and this protection is valuable. That people derive utility from wealth-holding is reflected in recent data showing individual wealth-holding at death to be at or near the lifetime peak.[4] Since annuities are available, the observation that people hold peak or near peak wealth at death suggests that people like to hold onto their wealth.[5] But, as a normative matter, I see no reason not to expect the recipients of transfer payments to use some of their own net worth to finance their own consumption.

2. HOW SHOULD WEALTH (NET WORTH) BE INCLUDED?

This section addresses the issue of what proportion of net worth should be counted in the measure of resources on which the transfer payment calculation is to be based. It does not give a specific answer, but it provides a framework within which various options can be compared, proceeding from Taussig's (7) way of conceptualizing total resources.[6]

Benefits in any transfer system can be expressed as a maximum benefit (that is, the amount a unit receives whose other resources are zero) minus a

specified percentage (usually expressed as a tax or benefit reduction rate) of total resources. Total resources can be viewed as earnings plus a proportion, as yet to be determined, of net worth. The stock of net worth will have a market yield which will be referred to hereafter as the rate of return. The proportion of net worth to be counted in our resource measure does not, of course, have to equal this rate of return. The proportion of net worth which we choose to include can vary from zero (in which case a dollar of net worth would be treated as if it were a dollar of earnings) to the extreme of twice unity plus the rate of return (in which case there would be a dollar for dollar benefit offset for the stock of, as well as the returns to, net worth).

For the stock of net worth to affect the benefit level of a transfer program--that is, for the benefit to go down as net worth increases--the proportion of net worth to be included in the measure of total resources on which the benefit is calculated must exceed the market yield of the stock of net worth. If it is just equal to the market yield the income that could be earned from it is included, but none of the net worth itself. If the proportion is less than the market yield, of course, it means that some even of the nonearned income remains untaxed.

For any given benefit schedule, the benefit reduction (or tax) rate on that part of total resources which is not earnings can be expressed in two eays. The first way is to express it simply as a percentage of nonearned income (that is, a percentage of the return). The second way is to express it as a percentage of the stock of net worth and assume that the return on net worth is taxed at the same rate as earned income.

Let us see how the two ways of looking at the issue compare, assuming a hypothetical transfer system with a tax rate of 50% and a rate of return of 5%. If the first way of expressing it (as a proportion of the return only) gives us an answer of 100%, the second way of looking at it will come out to 2.5%. If a transfer system is proposed which calls for equal rates of taxation on nonearned income and earnings, and a 15% "imputation" of net worth, the fraction of net worth to be counted in total resources will come out to be four times the rate of return. This implies a 200% benefit reduction rate if it is based on the return to net worth, which is equivalent to a 7.5% reduction rate if it is based on net worth.

Table 1 compares two alternative ways of expressing the benefit reduction rate for different proportions of net worth included in the measure of total resources (used as a basis for the benefit calculation). To the extent that categories of net worth are exempt in a particular transfer system, the benefit reduction rates will be correspondingly lower than they appear in the table.

Table 1

Comparison of Alternative Ways of Expressing the Conditioning of Transfer Payments on Net Worth

Proportion of Net Worth Counted in the Measure of Resources	Benefit Reduction Rate	
	as percentage of nonearned income	as percentage of net worth, assuming the return to net worth is taxed at the same rate as earnings
0.0	0%	0.0%
.05	50	0.0
.10	100	2.5
.15	150	5.0
1.05	1050	50.0
2.1	2100	100.0

3. THE ISSUE OF THE LIFETIME ACCOUNTING PERIOD

With a lifetime accounting period, no explicit consideration of net worth for tax-transfer systems need be made. A lifetime accounting period is attractive on conceptual grounds as a way of redirecting transfers from the "transitory" to the "permanent" poor. It is also conceptually attractive as a way of making the tax system neutral with respect to the timing of income received—thereby promoting equity amoung taxpayers in a lifetime sense. However, to the extent that the tax and transfer systems pursue different objectives, there is no reason to expect similar accounting periods to be optimal vehicles for accomplishing the goals of both.

The Lifetime Consumption Tax

Taussig's paper (7 in this volume) presents a lifetime model that would integrate both taxes and transfers into one system, and use as the tax-transfer base not lifetime resources but lifetime consumption. Even if one embraces the notion of a lifetime accounting period, one might well reject the model as presented.

The consumption tax as proposed by Taussig would tax "uses" not "sources" of resources. It would tax individuals differently according to their tastes and would, thus, be inequitable in this sense. Let $Y \equiv C + A$, with Y being lifetime resources, C lifetime consumption and A lifetime transfers. Lifetime resources, Y, is a full accretion measure, including all earned income and returns to capital as well as all gifts and inheritances received; C is own consumption over the lifetime; A is all transfers, gifts, and bequests made to others (and not taxed under Taussig's plan).[7]

The rational individual allocates his lifetime resources such that the marginal utility of own consumption per dollar after taxes equals the marginal utility of transfers per dollar. If we compare individuals having the same Y, it is obvious that those with a stronger taste for A will pay less tax. Hence this system is horizontally inequitable unless utility is considered a function only of one's own consumption.

Taussig's definition of the tax base would also be vertically inequitable if individual behavior with regard to A varies by wealth class. Individuals can augment their children's future economic welfare in many ways. They can feed and clothe them; provide education, books and activities; and give them stocks and bonds. If my reading of the proposal is correct, the provision of food, clothing, books, education, etc., are considered consumption and thus taxable over the exemption level, while the provision of stocks and bonds is not. But lower income parents provide the former commodities while higher income families can provide both the former and latter commodities—the system will thus be vertically inequitable. Define C1 as the commodities in excess of the exemption level provided by "poorer" families for their children, and C2 the commodities provided by the wealthier families in excess of C1. If the relevant good provided by the parents is the enhancement of children's economic welfare, the poor family pays a tax of tC1 on a good of C1, implying an effective rate of tC1/C1 or t. The wealthy family provides C1 + C2 and pay a tax of tC1, implying an effective tax rate of $\frac{tC1}{C1 + C2}$ (which is always less than t as long as C2 is positive).

In general, the regressivity of this consumption tax depends upon the degree to which the demand elasticity of A with respect to Y exceeds unity,

the more elastic the more regressive. Such regressivity could be offset with an increasing marginal tax rate on nonexempt consumption or a sufficiently high exemption level. The problem is, we have no idea what the elasticity of A with respect to Y is, so predicting distributional consequences is guesswork.

Conceptually, the inequities of the lifetime consumption tax disappear if we define the relevant distributional unit not as the lifetime utility of an individual but as the utility of an infinitely long-lived family dynasty. Then, as long as one member of the dynasty consumes the intergenerational transfers made by a previously born dynasty member, equity across dynasties will be restored. Even in this case, however, equity is not guaranteed. If the original transfer is never consumed, equity among dynasties will never be restored.

A simply alternative that would restore equity to the system would be to define all intergenerational transfers as consumption. (Taussig mentions this possibility at the end of section 2.) In so doing we would, of course, be defining a lifetime resources or accretion tax (since $Y \equiv C + A$).

It was mentioned at the conference that if nontaxation of intergenerational transfers is considered a problem, a supplemental estate or gift tax (as we have under present law) could be added to the system. However, under our existing income tax system, earned and nonearned income destined for intergenerational transfers are taxed when received.[8] When the transfer is made, the portion of the transfer above the exemption level is taxed again. The presumable justification for this treatment is to reduce the concentration of wealth and to reduce intergenerational immobility

in economic welfare. One must point out, however, that under existing federal tax law, the estate tax (especially since the 1976 Tax Reform Act) only taxes the top estate percentiles. The lifetime consumption tax as proposed would not tax income destined for transfer as under present law, or as received by donees. An accretion tax base would.

The remaining justification for the lifetime consumption tax (as opposed to a lifetime accretion tax) appears to be its stimulative effect on saving. I will discuss the daving issue in section 4.

The Lifetime Accretion Tax

A lifetime accretion tax is conceptually attractive. Accretion would be automatically averaged over the life cycle and no explicit consideration of net worth would be necessary. Though this system is attractive in the realm of positive taxation, however, I have some reservations about its use for transfer programs. If a previously affluent person goes to economic ruin and has no earnings, should we grant him the same amount as one who permanently earns nothing? If the history of lifetime accretion is taken into account, the formula would say no. Society, though, is unlikely to agree. After all, the person's lifetime average accretion might be well above some breakeven level, but the individual is needy now. If the individual has savings, we could deny him transfers and be consistent with the lifetime principle, knowing that he can survive by consuming his savings. (This would, of course, mean the transfer system is wealth conditioned.) But if he has little savings because he thought his income level was permanent, or for other reasons, society will not let him starve.

The fact is that society does not completely accept the life-cycle notion; bankruptcy laws give people a fresh start, and the once prosperous

who go to ruin are not allowed to starve. The lifetime notion would cause difficulties as well if a person went from rags to riches. Suppose an individual who, for most of his life, received transfer payments experienced a sudden and dramatic increase in income such that his lifetime level was above the breakeven point. Adherence to the lifetime principle might require very high marginal tax rates, essentially taxing back the previously received transfers. If the increase in income was a consequence of his own efforts (if, for example, his business became successful) the disincentive effect of such a high marginal tax rate would be severe.

Thus, though lifetime accretion as a tax-transfer base is attractive on conceptual grounds, its feasibility is questionable, particularly with respect to a transfer (as opposed to a tax) system.

4. NET WORTH CONDITIONING AND INTER-COHORT COMPARISONS

How are we to compare the relative economic position of people in different birth cohorts possessing similar amounts of earnings and wealth? If the transfer payment is wealth conditioned, the annuity approach would result in transferring less to the older person since he has fewer remaining years of consumption to finance. A wealth imputation approach using a fixed percentage each year, or a fixed time horizon, would be neutral across age groups.

If the economy is growing in real terms and we expect that the younger of the two will participate in this growth, cannot we say the younger individual is better off? The answer depends on whether poverty is a relative or absolute concept. If our conception of the poverty level (as measured by the poverty line) grows in real terms along with productivity growth,

we cannot say the younger person will be better off if his relative position in the income distribution is unchanged over time.

Since individuals in different birth cohorts experience different income opportunities over their lifetimes, one might suggest conditioning transfer payments on the relative position of the individual in his age group. This procedure encounters an additional difficulty, differential mortality. Suppose death is a nonrandom sample, such that lower income people have lower survival probabilities. The elderly person in the ith resources percentile of his surviving age group is a relatively more affluent member of his original birth cohort than the younger person in the ith percentile of his age group. This is because the less affluent members of the original birth cohort have died in disproportionate numbers and, consequently, the older person is at the ith percentile of a smaller, more select group than the younger person is.

Do we have differential mortality in the United States? That infants born into poorer families die in proportionate numbers has been shown, after the use of appropriate socioeconomic controls, by Gortmaker (1977).[9] The evidence of differential mortality among adults is less clear. Kitagawa and Hauser (1973) show substantial differences in mortality rates among whites and blacks, by income class, for Chicago SMSA residents. However, the figures presented are controlled by race, not socioeconomic determinants as such. British data discussed by Shorrocks (1975) suggest differential mortality by wealth exists in Great Britain.

5. SAVINGS EFFECTS

Will saving be reduced by net worth conditioning? And is this bad?[10] The first is a positive, the second a normative question. With the exception of Moon's paper (2) the conference brought little careful analysis to bear on the first question and there was no discussion at all concerning the second question. The conventional wisdom is that asset conditioning will reduce saving. The negative effect on saving may very well be true, but I can construct a scenario in which saving will rise.

Suppose a public retirement program that was not asset tested becomes so. An individual planning to hold assets at retirement, in part to finance a consumption level higher than the level supported by the public program, now faces a loss of benefits as a consequence of the new rules. If he is a target saver who wants to maintain a level of consumption close to the level he has grown accustomed to (his "permanent" level), he might save more as a consequence. Target savers are not irrational; they only have kinked indifference curves. Furthermore, a reduction in saving could be offset by other changes, i.e., the use of monetary policy to leave macro-saving unchanged.

Is a lower saving rate bad? The answer is a value judgment that hinges on how one values the welfare of the future generation compared to that of the present one. One could argue that, since the next generation is likely to be richer than the present generation due to real productivity growth, we are worried about a change that would actually take less from the poor. We have sufficient poor in this generation to be concerned with--why worry about richer future generations?

6. PROBLEMS OF WEALTH CONVERSION

If transfers are to be wealth conditioned we need some new institution that would allow one to consume smoothly out of one's wealth, whatever form it is in. Indeed, it is inhumane to base transfers on the flow equivalent of a stock if the stock itself can not practicably be converted into a flow of consumption benefits. Chen's (paper 6) housing annuity plan is a possibility. Another is Taussig's idea (paper 7) of a lien against assets, paid up at death or when the asset is disposed of. Note that the property lien in a world of wealth conditioning is really a humane way of allowing a person to consume out of capital which cannot be liquidated evenly.

7. CONCLUSION

Conditioning transfers on the basis of all resources, both income and net worth, is efficient since it directs the available resources in a way that gives the most to those with the least resources available for consumption. It is also equitable since all available resources enhance a person's economic welfare. There is no tradeoff between equity and efficiency here; indeed, the efficient policy is also equitable. Additional redistribution, if so desired, could be accomplished by raising guarantee levels or lowering the benefit reduction rate.

As a normative matter, I see no reason not to expect people to consume some of their net worth to finance their own consumption. Not to recognize certain resources, because they are stocks and not flows, makes no sense to me.

NOTES

[1]If wealth matters we clearly have to measure the importance of wealth in people's economic position. The data currently used for this purpose, The Survey of Financial Characteristics of Consumers, is badly dated. A new empirical base is needed.

[2]Fromm and Taubman (1973) discuss this issue in detail.

[3]A wealth tax does exist on the local level, the local property tax, though only one segment of wealth, real property, is taxed.

[4]See Smith (1975) and Mirer (1977).

[5]Economists have been amazed at the reluctance of people to make inter vivos transfers before death in order to attenuate death taxes (Shoup 1966).

[6]The argument that follows in the text can also be expressed algebraically. Using Taussig's notation, let the transfer system be portrayed as

$$B = G - t(Y)$$

$$Y = E + \alpha W$$

with a breakeven point of $E + \alpha W = \frac{G}{t}$, where B represents the transfer benefit, t the benefit reduction (tax) rate, Y total resources (made up of earnings (E) and a fraction (α) of net worth (W)--α being the policy variable. Let us further assume that return to net worth is r% and that the accounting period is optional. As an index of policy alternatives, α can vary from zero to $(r + 1)/t$. The former would ignore the stock of wealth and all nonearned income from it. The latter would result in a dollar for dollar benefit offset to the stock of and returns to net worth. Though the second polar extreme seems unrealistically harsh, Lurie's paper (3) indicates that this practice is actually followed in some places. If wealth is to matter

or, more specifically, if transfer payments are to be conditioned on the stock of net worth, then α must exceed r. In Table 2 the range of alternatives is presented algebraically. Options A and G are the polar extremes mentioned above. Option B would base transfers only on the income from, and not the stock of, net worth. Option E is a general presentation of the formula; its ordering in the array depends on the value of k, an arbitrary constant. If transfers are to vary inversely with net worth, then k must exceed unity.

The annuity approach can easily be incorporated into this formula. If, under the annuity approach, nonearned income is taxed as earnings and the stock of wealth is amortized equally over the life expectancy of the individual, α is equal to $r - \frac{1}{LE}$, where LE is the individual's life expectancy.

Table 2

An Algebraic Array of Options for Net Worth Conditioning of Transfer Payments

	Benefit Reduction Rate	
Option	as a percentage of nonearned income	as a percentage of the stock of net worth assuming the return to net worth (rW) is taxed at the same rate as earnings
A. $\alpha = 0$	0	0
B. $\alpha = r$	t	0
C. $\alpha = 2r$	2t	rt
D. $\alpha = 3r$	3t	2rt
E. $\alpha = kr$	kt	(k - 1)rt
F. $\alpha = r + 1$	$\frac{(r + 1)}{r}t$	t
G. $\alpha = \frac{(r + 1)}{t}$	$\frac{r + 1}{r}$	1
Annuity Approach		
H. $\alpha = r + \frac{1}{LE}$	$(\frac{1}{LEr} + 1)t$	$\frac{t}{LE}$

[7]Richard Musgrave (1977) in his critique of the Treasury's Blueprint for Basic Tax Reform (1977), points out that exemptions of transfers from the tax base requires the Treasury to make matching grants for all transfers, with the matching rate equal to the grantor's marginal tax rate.

[8]With the exception that unrealized capital gains are not taxed at death but when realized, if ever, by the heirs.

[9]This suggests that transfers from people who are not likely to have infants, including the elderly, to those who are likely to have infants, might save lives.

[10]Another relevant issue is the degree to which net worth conditioning will result in interpersonal transfers. How elastic is the demand to transfer assets with respect to asset taxation? I know of no estimates of this important relationship.

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